Gabhart v. Gabhart: An Indiana Response to Corporate Freeze-outs

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In 1968, the plaintiff in Gabhart v. Gabhart, and four individual defendants (his father, his two brothers and a non-relative), formed Washington Nursing Center, Inc. for the purpose of operating a nursing home in southern Indiana. Each party held one-fifth of the outstanding shares in the corporation; each was a director, and the defendants were also officers.

Within a brief period the relationship between the parties deteriorated. Gabhart, the plaintiff, resigned in 1970, and defendants attempted to purchase Gabhart's shares in the corporation but negotiations failed. Thereafter, defendants used their majority voting power to merge the existing corporation into Washington Health Services, Inc., a corporation which they formed in technical compliance with Chapter Five of the Indiana General Corporation Act. While defendants continued as shareholders in the new corporation, plaintiff was reduced to the status of creditor.

Plaintiff did not attend the shareholders meeting at which the vote was taken for merger, nor did he avail himself of the statutory appraisal rights provided for dissenting shareholders. Instead, plaintiff brought an action in federal district court which, inter alia, attacked the validity of the "freeze-out" merger, claiming that its sole purpose was to deprive him of his equity interest. The district court granted defendants' motion for summary judgment, holding that appraisal was plaintiff's exclusive remedy. On appeal, the Seventh Circuit viewed the case as presenting

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2. Plaintiff claimed to have been denied access to corporate books and participation in the corporate operation, which necessitated the filing of two successful stockholder's suits. Brief for Plaintiff-Appellant at 8, Gabhart v. Gabhart, No. 75-2090 (7th Cir. 1977). Defendants claimed the plaintiff's lawsuits undercut the ability of the corporation to secure financing. Appellant's Appendix at 59-60, Gabhart v. Gabhart, No. 75-2090 (7th Cir. 1977) (affidavit of corporation's president).
3. Washington Health Services, Inc. was the statutorily designated "surviving corporation". IND. CODE § 23-1-5-5(a)(1) (1976).
6. The defendants remained directors and officers of Washington Health Services, Inc. After the merger, the name of Washington Health Services, Inc. was changed to that of the merging corporation, Washington Nursing Center, Inc., whose existence had "ceased" under the merger statute. IND. CODE § 23-1-5-5(b) (1976).
7. The plaintiff received interest bearing debentures for his shares. IND. CODE § 23-1-5-2(a)(3) provides that a shareholder's stock may be converted "into shares or other securities or obligations of the surviving corporation or ... into cash ...." Under IND. CODE § 23-1-5-7 (1976), a shareholder entitled to vote in regards to a merger may "object" and "demand" payment for the value of his shares. A judicial appraisal procedure is available if the value cannot be otherwise agreed upon.
8. Federal jurisdiction was based on diversity of citizenship.
"important questions of first impression under Indiana corporation law" and certified several questions to the Indiana Supreme Court. One of the questions inquired into the validity of freeze-out mergers. The Supreme Court of Indiana decided that minority shareholders may enjoin a merger that does not advance a corporate interest.

This note analyzes the Indiana Supreme Court's first encounter with a freeze-out merger. The analysis begins with a background to the general freeze-out concept; then, Gabhart will be reviewed for the purpose of clarifying the courts' view of the statutory dissolution process within the freeze-out context and the purposes that would validate the freeze-out merger. The analysis will conclude by delineating corporate transactions that could be subject to the decision.

THE COURTS' RESPONSE TO FREEZE-OUTS

The "freeze-out" is well known to corporate law and has been defined as the use of corporate control vested in the statutory majority of shareholders or board of directors to eliminate minority shareholders or reduce to insignificance their voting power or claims on corporate assets. Freeze-outs take a variety of forms. For example: (1) majority shareholders may sell corporate assets to themselves or other entities which they control; (2) majority shareholders may dissolve the corporation and acquire the assets upon liquidation; (3) majority shareholders may merge or consolidate the corporation under a plan unfavorable to continued minority participation; (4) majority shareholders may drain the corporation's earnings in the form of large salaries and bonuses, high rent paid by the corporation for property leased from majority interests, or large payments by the corporation under contracts between the corporation and majority interests.

For an examination of other types of freeze-out cases, see Note, Remedies for Oppression in Close Corporations in Indiana, 41 Ind. L.J. 265 (1966).

See generally F. O'Neal, OPRESSION OF MINORITY SHAREHOLDERS (1975).
Courts have struggled with freeze-outs for many years, endeavoring to fashion acceptable limits to the use of corporate control, but have often reached inconsistent results.\(^2\) Pressure on courts to establish limits to the power that attaches to corporate control has intensified in recent years resulting from the decision by many publicly held corporations to “go private”.\(^2\)

Courts that have recently considered the Gabhart-type freeze-out have generally adopted a “fairness”\(^2\) or “business purpose”\(^2\) standard to

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\(^2\)Compare Watkins v. National Bank of Lawrence, 51 Kan. 254, 32 P. 914 (1893), in which majority shareholders were allowed to vote a corporation into liquidation against the wishes and interests of minority shareholders, with Theis v. Spokane Falls Gaslight Co., 34 Wash. 23, 74 P. 1004 (1904), in which majority shareholders were precluded from using dissolution and sale to a new corporation as a freeze-out technique. An examination of later cases reveals further inconsistency. See Vorenberg, Exclusiveness of the Dissenting Stockholder’s Appraisal Right, 77 Harv. L. Rev. 1189, 1194-1200 (1964).

\(^2\)That is, to eliminate their public shareholders and return to a privately held status. The “going private” fad developed in 1974 and 1975 when market prices for most publicly traded shares were low. Procedures used to eliminate public shareholders include tender offers, reverse stock splits, and freeze-out mergers. See Brudney, A Note on: “Going Private,” 61 Va. L. Rev. 1019 (1975); Moore, Going Private: Techniques and Problems of Eliminating the Public Shareholder, 1 J. Corp. L. 321 (1976). Reducing the number of shareholders to less than 300 enables a corporation to deregister its shares under § 12(g)(4) of the Exchange Act, 15 U.S.C. § 78l(g)(4) (1976); additionally, the requirements of § 15(d) are suspended as of the beginning of the first fiscal year in which the number of shareholders is less than 300. \(\text{Id. at } \text{§ 78o(d).}\) “Going private” enables the corporation to free itself of the reporting requirements, the proxy rules, the inside trading rules, and other provisions of the Exchange Act. Other justifications offered for “going private” include: (1) the possibility of more prudent management in the absence of the pressures accompanying public ownership; (2) the savings of direct and indirect legal, accounting, and reporting costs incurred by a publicly held company; (3) the elimination of potential conflicts of interests involving the allocation of resources, expenses, and corporate opportunities; (4) lifting the morale of key employees whose stock options are worthless because of a declining market; and (5) preventing a cyclical stock market from placing a ceiling on the value of the corporation should the controlling stockholders decide to sell. Borden, Going Private—Old Tort, New Tort or No Tort?, 49 N.Y.U.L. Rev. 987, 1002-20 (1974). For the SEC response to the “going private” trend, see Note, SEC Rulemaking Authority and the Protection of Investors: A Comment on the Proposed “Going Private” Rules, 51 Ind. L.J. 433 (1976). It is now evident that minority shareholders will generally be restricted to state remedies if they are subjected to freeze-out transactions. See Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977). This will undoubtedly increase the significance of Gabhart.

\(^2\)See e.g., Berkowitz v. Power/Mate Corp., 135 N.J. Super. Ct. 36, 342 A.2d 566 (1975). Corporate officers and directors who engage in self-dealing transactions have a heavy burden of showing that they have not violated their fiduciary obligations to the minority stockholders. At a minimum their conduct is subject to a searching inquiry to determine whether it conforms to accepted concepts of fairness and equity. It may well be that the public stockholders of Power/Mate would benefit from the purchase of their stock. If so, the question at issue is whether the price they are being offered for their interest in Power/Mate is a fair and reasonable one. \(\text{Id. at 49, 342 A.2d at 574.}\)

\(^2\)See e.g., Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir. 1974). In the absence of [a] business purpose [the surviving corporation] was purely a sham party created to circumvent the rule of law that prohibits a majority of stockholders of a corporation, absent any charter provision as to the contrary, to force the minority interests to surrender their stock holdings. Implicit in this holding is a construction of the Georgia statute that comports with equity in good conscience.
judge the validity of the transaction. Both standards are premised upon fiduciary obligations courts deem owing by the majority to minority shareholders.

In the recent case of Singer v. Magnavox, the Supreme Court of Delaware utilized both the fairness and business purpose standards. In that case, the North American Phillips Corporation had formed a subsidiary to make a tender offer for all Magnavox Company shares. A minority group of Magnavox shareholders rejected the tender offer but were bought out in a subsequent merger of the corporations. The court viewed freeze-out mergers as "an abuse of corporate process" and further stated:

This is not to say ... that merely because the [c]ourt finds that a ... merger was not made for the sole purpose of freezing out minority shareholders, all relief must be denied .... On the contrary, the fiduciary obligation of the majority to the minority stockholders remains and proof of purpose...will not necessarily discharge it. In such case the court will scrutinize the circumstances for compliance with the ... rule of "entire fairness" and if it finds a violation thereof, will grant such relief as equity may require.

Later, in Tanzen v. International General Industries, Inc., the Delaware court elaborated on the "purpose" which would validate a freeze-out merger, by finding that elimination of minority shareholders may be justified if it advances the bona fide business purpose of the majority shareholders.

In Gabhart, a unanimous Indiana Supreme Court declined to either "embrace" or "ignore" the reasoning and views of such courts as Singer and Tanzen which have faced the freeze-out question. The court defined its objective as balancing the need to protect the "interests and expectations" of minority shareholders with the need to allow the corporate "flexibility" required by modern commerce. Instead of basing its analysis on the common law concept of fiduciary duty, the court looked to the entire Indiana General Corporation Act. They found the Chapter Five merger provisions to have uncertain application in the freeze-out

Id. at 570.


25 Id. at 980.

26 Id.


28 379 A.2d at 1124. In Tanzer, the court accepted a parent corporation’s freeze-out of the minority interest in a subsidiary corporation in order to facilitate the long term debt financing of the parent. The court found, however, that the transaction would still have to withstand examination under the "entire fairness" part of their test. Id. at 1125.


30 370 N.E.2d at 355.

31 Id. at 359-54.


33 Id. §§ 23-1-5-1 through 23-1-5-8.
context. Then, the court proceeded to consider the voluntary dissolution provisions of Chapter Seven,\(^4\) noting:

[They are] obviously indifferent to both minority interests and corporate interests. If the statutory majority sees fit to dissolve a profitable going concern in order to enhance their own interests, they may do so without regard for the corporation's best interests. The purpose of voluntary dissolution is to permit the severance of relationships existing among shareholders, and if corporate suicide benefits all shareholders alike, it is ... coincidence ....\(^5\)

The defendants in Gabhart had argued that the appraisal remedy provided under the merger provisions was intended to be exclusive.\(^6\) But the court found that because minority shareholders are provided no right of appraisal in the event of voluntary dissolution, the "exclusivity" argument would be inapplicable under these statutory provisions and minority shareholders, who feel "improperly disadvantaged" or question "the fairness" of a voluntary dissolution, may subject the liquidation and distribution of corporate assets to "all principles of equity."\(^7\) The court then held:

That in a bona fide merger proceeding, a dissenting or non-voting shareholder is limited to the [appraisal remedy]. But we further hold that a proposed merger which has no valid purpose, which we construe to mean a purpose intended to advance a corporate interest, and which merger would eliminate or reduce a minority shareholder's equity, may be challenged as a de facto dissolution, by shareholders entitled to vote upon the issue of dissolution. Such shareholders may enjoin the merger.\(^8\)

In other words, some mergers may be construed as dissolutions, thereby extending to minority shareholders such remedies as are available under "all principles of equity."

This holding presents at least two issues of interpretation. The court's view of the dissolution process is unclear, as is the meaning of "a purpose intended to advance a corporate interest."\(^9\) The importance of Gabhart lies in the resolution of these questions.
Although a merger was directly in issue in Gabhart, the case adds judicial gloss to statutory dissolutions as well. The import of the court’s reference to voluntary dissolution as a means for majority shareholders "to enhance their own interests" is not clear. Dissolution is a classic freeze-out device. Majority shareholders may purchase the dissolving corporation’s assets, or adopt a liquidation plan which provides cash dividends to minority shareholders and assets to themselves. Thus, Gabhart might be interpreted as encouraging a form of freeze-out through dissolution. However, this seems unlikely because the court, for the sake of minority shareholders, imposed “all principles of equity” on the dissolution process. Unfortunately, the court did not articulate these “principles.”

Some clarification however, can be found by looking to the case law of other states. Other courts, exercising equitable powers, have reacted to freeze-out dissolutions in three distinct ways. Some courts refuse to intervene, not even to the extent of requiring majority shareholders to purchase minority assets at going concern value, because a corporation being dissolved and liquidated is not technically a going concern. Other courts have provided affirmative relief to minority shareholders because of fiduciary obligations which attach to majority status. These courts

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40See note 35, supra, and accompanying text.

41In the 1904 case of Theis v. Spokane Falls Gaslight Co., 34 Wash. 23, 74 P. 1004 (1904), the Supreme Court of Washington said:

The practice is one which is frequently indulged in for the purpose of what is described in vulgar phrase as “freezing out” small shareholders; a compliance with the letter instead of the spirit of the statute; a pernicious practice, which courts of equity cannot too promptly condemn. A dissolution of a corporation, within the contemplation of the law, is the death of the corporation. It means a disintegration, a separation, a going out of business.

But in this case, all the elements of dissolution are wanting. The corporation, with a slightly different name, proceeded in the same town, with the same property, the same powers, and substantially the same owners. All the difference is about what was testified by the president of the corporation—that, after the new company was formed, the minority stockholder’s interest would be represented by a deposit in the bank instead of stock in the corporation.

Id. 29-30, 74P. at 1006. See generally Hornstein, Voluntary Dissolution-A New Development in Intra-Corporate Abuse, 51 Yale L. J. 64 (1941). See also note 19, supra, and accompanying text.

42See e.g. Kritz v. Grossman, 463 S.W.2d 541 (Mo. App. 1971).

4370 N.E.2d at 356.

44Under this view a minority shareholder would receive a proportionate part of the book or liquidating value of the corporation, receiving no compensation for such items as goodwill. See e.g., Rossing v. State Bank of Bode, 181 Iowa 1013, 165 N.W. 254 (1917); Watkins v. National Bank of Lawrence, 51 Kan. 254, 32 P. 914 (1893).

45In Indiana, a fiduciary obligation runs from the directors and officers of a corporation towards the corporation and each shareholder. See e.g., Hartung v. Architects Hartung/Odle/Burke, Inc., ___ Ind. App., 301 N.E.2d 240 (1973). Indiana has not established that a fiduciary duty runs from the majority shareholders to the minority shareholders; however, it appears that a fiduciary obligation is recognized to exist between shareholders
allow majority shareholders to distribute corporate assets in kind or sell them at public auction and distribute cash. However, all shareholders must be treated equally; the minority may not be eliminated against their will. Other courts have not enjoined freeze-out dissolutions, but have allowed minority shareholders to recover their proportionate share of the enterprise at its going concern value.

In a freeze-out dissolution, Gabhart appears not to limit a court to granting minority shareholders only the book value or going concern value of their interest. Book value would put minority shareholders in a worse position than with a freeze-out merger, while statutory appraisal, available with a merger, would merely assure the minority going concern value. Accordingly, granting book value is inconsistent with the court's concern for the minority's "interests and expectations." Similarly granting going concern value, which puts the minority in the same position as with a freeze-out merger, is inconsistent with the court's state-

of a closely held corporation. See id. Directors and officers are precluded from using their powers oppressively, W. Q. O'Neal Co. v. O'Neal, 108 Ind. App. 116, 25 N.E.2d 666 (1940), or from using the assets of a corporate entity for their personal gain, Cole Real Estate Corp. v. People's Bank & Trust Co., Ind. App., 310 N.E.2d 275, 279 (1974), or from directly or indirectly deriving any personal profit or advantage by reason of their positions, or from utilizing their influence and advantage of office for any but the common interest, Tower Recreation, Inc. v. Beard, 141 Ind. App. 649, 231 N.E.2d 154 (1967). Accord generally Leader Pub. Co. v. Grant Trust, etc. Co., 182 Ind. 651, 108 N.E. 121 (1915). It is obvious that any of these established equitable concepts might be deemed violated in a freeze-out dissolution. Moreover, even if Indiana law failed to recognize a fiduciary obligation owed by the majority interests to the minority, the existing law could effect freeze-outs in closely held corporations where a fiduciary duty runs between the shareholders in ter se and where many shareholders will also be officers and directors.


Under IND. CODE 23-1-5-7 (1976) a minority shareholder is entitled to the fair market value of his interest at the effective date of the merger.

It has occasionally been suggested that statutory appraisal proceedings tend to produce overly conservative estimates of the value of the minority's interest. E.g., Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 HARV. L. REV. 1189, 1202 (1964). If this was true, a minority shareholder might benefit from application of the dissolution provisions in that a court would not have to estimate the value of his interest within the confines of IND. CODE 23-1-5-7 (1976). However, Indiana courts do not view the statutory appraisal provision as mandating overly conservative results. See General Grain, Inc. v. Goodrich, 140 Ind. App. 100, 221 N.E.2d 696 (1966) which established the following guideline for operating under the appraisal statute:

[D]ifferent elements of value, such as book value, liquidating value, stock market value, evidence of sales in the market, the type of market available, the condition of the issues financial, managerial, and past [.] ... present, ... [and] future possibilities and probabilities together with all other elements which tend to affect the fair market value, for case, of course, are worthy of consideration ....

ment that more than form is at stake. Thus, the logical conclusion is that *Gabhart* permits freeze-out dissolutions to be enjoined.

*Gabhart* provides little other guidance regarding the court’s view of the voluntary dissolution process. There is clearly no problem when a true “suicide” of the corporation occurs, with all shareholders extracting their investment to start afresh in other endeavors. There is also no problem if essentially the same enterprise continues after dissolution, as long as all shareholders are treated equally and minority shareholders are able to retain their interest in the ongoing enterprise. However, in other circumstances, when the transaction eliminates or reduces the minority interest, a freeze-out minded majority proceeds under peril of indeterminate judicial intervention on behalf of minority shareholders.

Like the “principles of equity” statement, the court in *Gabhart* offered little insight into the meaning of the phrase “a purpose intended to advance a corporate interest.” They did provide an example of what is not a “legitimate corporate purpose”: when majority shareholders, also serving as officers and directors, use a freeze-out merger as a shield against minority shareholder derivative actions. In addition, the court discussed, without expressly endorsing, the view of the Washington Supreme Court in *Matteson v. Ziebarth* that an “uncooperative” minority shareholder may be eliminated by freeze-out merger if this is “the only salvation” for a near bankrupt corporation.

The court clearly did not adopt the Delaware view that the requisite purpose can be that of the surviving corporation and the majority shareholders. However, it is difficult to theorize circumstances in which the business of the merged corporation would necessitate elimination of

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81 370 N.E.2d at 356.
82 See note 86, infra, and accompanying text.
83 See note 39, infra, and accompanying text.
84 See note 12, supra.
85 370 N.E.2d at 337.
87 In *Matteson* the only chance for the stockholders of Ziebarth Corporation to recoup their investment was through a merger or marketing arrangement with another corporation. Id. at 302, 242 P.2d at 1035. A majority shareholder proposed an agreement with a purchaser who would not buy less than all of Ziebarth’s stock. Under the proposed agreement, the majority shareholder would also be employed by the purchaser. A minority shareholder refused to go along with the agreement unless the majority shareholder would submit to the “wholly improper proposal” of giving the minority shareholder twenty-five percent of his earnings as an employee of the purchaser. Id. at 305, 242 P.2d at 1036. The minority shareholder was eliminated through a freeze-out merger to allow the purchase agreement to be carried out.
88 See note 28, supra, and accompanying text.
89 This observation is based on the following *Gabhart* statement:

[T]he policy favoring corporate flexibility is not furthered by permitting the elimination of minority interests for the benefit of the majority, when no benefit accrues to the corporation.

370 N.E.2d at 354. To assess the “corporate interest” from the view of the surviving corporation would, of course, merely measure the benefit of the transaction to the majority shareholders.
minority interests. For example, justifications for “going private” seem as much for the benefit of the majority as that of the corporation. Cases from other jurisdictions adopting versions of the corporate purpose rule do not offer clear instruction.

Despite this ambiguity it is possible to find a measure of certainty by looking to the underlying policy of the corporate purpose rule. For credibility, any such policy must be derived by following the same approach used by the court – analysis of the corporate statutory scheme.

As noted by the court, under the common law of Indiana, as well as other jurisdictions, mergers and other fundamental corporate changes were subject to unanimous shareholder approval. This rule reflected corporations of the time: small groups of active entrepreneurs, often family, participating in localized, small-scale business operations. It was appropriate to treat shareholders like partners, requiring unanimous consent when an action exceeded that contemplated in the partnership agreement. Because large amounts of new capital were needed to fund the spread of industrialization, numerous dispersed and passive investors were integrated into the corporate framework; it became impractical to provide this new breed of stockholder with the attributes and power of a partner. Consequently, the common law rule that a sale of all assets, merger, consolidation, or dissolution of a profitable corporation required unanimous shareholder approval was abolished by statute to enhance corporate “flexibility.” State legislatures have continued to pay par-

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6See note 22, supra.
61For example, the trial court in Bryan v. Block & Blevins Co., Inc., see note 23, supra, rejected the defendant’s argument that the freeze-out of the plaintiff, a former employee, was justified because the corporation had a policy of allowing only employees as shareholders. The trial court found the policy was not firmly established. However, it is not clear whether the court would have found the reason acceptable if the policy had been firmly established. See Bryan v. Block & Blevins Co., Inc. 343 F. Supp. 1062, 1068 (D. Minn. 1972).
6The Indiana General Corporation Act, IND. CODE § 23-1-1-1 et seq. (1976), was originally enacted in 1929. The Act drew extensively from the Uniform Business Corporations Act (1927) and from the corporate law of the leading commercial states. Dix, The Indiana General Corporation Act, 5 IND. L. J. 107 (1929). There have been extensive amendments and additions through the years. However, the basic structure of the original Act remains intact.
370 N.E.2d at 352.
6See e.g., Schaffer v. General Grain, Inc., 133 Ind. App. 598, 182 N.E.2d 461 (1962): The consequent power of a dissenting stockholder to obstruct and prevent the merger of one corporate existence with another, under the economic necessities of the advancing years, frequently proved a confusing and stifling hand upon the corporate expansion, growth and industrial development with the resulting disadvantage to other stockholders. To obviate this difficulty ...
Indiana ... enacted ... [the merger provisions of the General Corporation Act] 133 Ind. App. at 611, 182 N.E.2d at 468. See also Lattin, The Minority Stockholder and
ticular attention to the statutory merger provisions, steadily amending them to further facilitate mergers.\(^6\)

While the policy of flexibility prevailed over certain interests of the minority, the new corporate statutes still contemplated fair treatment.\(^7\) Fairness in this context seems to dictate two things: (1) that minority shareholders are entitled to the same treatment as majority shareholders, each receiving an interest in the ongoing corporation or the same consideration per share for their interest; and (2) that the economic value of what minority shareholders give up will be equal to what they receive.\(^7\) These factors are implicitly integrated into the statutory merger schemes. Because these schemes were designed for the merger of independent entities,\(^7\) separate managements would normally be negotiating at arm's length. This, plus the availability of statutory appraisal, assures minority shareholders equality of treatment and exchange.\(^7\) Accordingly, the abrogation of common law minority rights has been tolerated by the judiciary, and constitutional attacks, based on impairment of contractual obligations, have failed.\(^7\)

The Gabhart-type merger is clearly outside statutory contemplation. Majority shareholders assure the absence of bargaining by being situated on both sides of the transaction. With the statutory balance upset, there is no inherent mechanism in the statutes safeguarding minority shareholders from unfairness.\(^7\) Because the Gabhart-type...

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\(^{6}\)For example, since 1969, cash, instruments of indebtedness, or securities, or any combination thereof, may be issued by the surviving corporation to the shareholders of the merged corporation; there is no explicit requirement that shareholders of the merged corporation have a continuing equity interest in the surviving corporation. IND. CODE § 23-1-5-2(a)(3). This is not necessarily a legislative endorsement of freeze-outs. By allowing a surviving corporation to pay some or all of the purchase price in cash, the surviving corporation can avoid severe dilution of its stock. Brundey, A Note on "Going Private", 61 Va. L. Rev. 1019, 1028 (1975).

\(^{7}\)See e.g., Dix, The Indiana General Corporation Act, 5 Ind. L. J. 107, 109 (1929).

\(^{7}\)See, e.g., Shortemeier, Indiana Corporation Law, 100 (1952).

\(^{7}\)See generally Greene, note 71 supra.


\(^{7}\)Even if he avails himself of appraisal, a minority shareholder will be precluded from sharing in the continued growth and income of the merged corporation, forced to find a subsequent equivalent investment, and will probably have to pay taxes as a result of the forced exchange.

\(^{7}\)This is especially true in the context of the type of corporation involved in Gabhart, i.e., a close corporation. Because close corporations are typified by a small number of shareholders and substantial shareholder participation in the direction and operation of the corporation, 1 F. O'Neal, CLOSE CORPORATIONS § 1.07 (2d ed. 1971), there is less fit with the policies that justify abandonment of the common law unanimity rule. See note 69, supra, and accompanying text. It is commonly recognized that one special aspect of close corporations is the opportunity afforded majority shareholders to oppress, disadvantage, and freeze-out minority shareholders. E.g., Wilkes v. Springside Nursing Home, Inc., Mass. __, 353 N.E.2d 687 (1976). Assuming that corporate flexibility might in some cir-
merger is not within the bounds of statutory contemplation, courts should narrowly construe the Indiana Supreme Court's corporate purpose standard. Only in exceptional cases, like Matteson v. Ziebarth, when a court is genuinely convinced that a freeze-out merger is "the only salvation" for the merging corporation, should the corporate purpose standard be deemed satisfied. Thus, the freeze-out merger would properly serve as a safety valve, not a day-to-day tool in corporate affairs.

**Transactions Affected by Gabhart**

The scope of Gabhart is difficult to ascertain due to the broad and general language in the opinion. For example, Gabhart seems literally applicable to mergers between independent corporations. However, this ignores the fact that the element of bargaining was absent in Gabhart. When independent corporations are involved, courts should warily entertain minority claims of lost or reduced equity and lack of corporate purpose in the transaction because arm's length bargaining is probably involved. No statutory policy would be served in the inevitable delay and uncertainty such an expansive reading of Gabhart would entail.

The question of scope is also raised within the context of the short-form merger. Although a "short-form" merger was not at issue in Gabhart, the court's language could be utilized to support an argument that this type of merger must be justified as advancing a corporate purpose. However, since this statutory provision expressly contemplates a parent corporations' summary elimination of a subsidiary's minority shareholders, a context in which bargaining could not be expected, it seems the Gabhart rationale would have no application.

On the other hand, the Gabhart rationale may apply in those situations where appraisal rights are denied minority shareholders of corporations...
registered on a national exchange. This exception did not apply in *Gabhart*; however, because such registration would not by itself insure arm's length bargaining, this exception should not alone preclude subjecting a transaction to the corporate purpose standard formulated in *Gabhart*.

Due to the concern expressed in *Gabhart* for preserving minority interests and expectations, the case will undoubtedly chill the use of all forms of the freeze-out in Indiana, not just mergers. However, a close reading reveals only limited applicability. For example, it is reasonable to assume that statutory provisions for sale of assets and voluntary dissolution, two other favorite freeze-out devices, contemplate dealings with third parties in the disposal of corporate assets. If such transactions took on freeze-out characteristics, without bargaining for the disposal of assets, it would be appropriate to apply the corporate purpose standard. However, the statutory bases for other freeze-out devices, such as reverse stock splits, are clearly intra-corporate transactions. Their validity would depend entirely on standards imposed by fiduciary obligations. *Gabhart* is silent in regard to such obligations.

**CONCLUSION**

*Gabhart* holds that a merger which eliminates or reduces minority equity and does not advance a corporate interest may be enjoined as a *de facto* dissolution. The case does not stand for the proposition that majority shareholders can simply turn to the dissolution type of freeze-out to accomplish their purposes because there is an express warning that courts may intervene in freeze-out dissolutions on equitable grounds. Although the circumstances that would validate a freeze-out merger are not clearly articulated, the corporate purpose test would only seem to be satisfied when no other reasonable alternative is available to majority shareholders. Despite the expansive language used in the opinion, the *Gabhart* rule is most applicable to the limited group of fundamental corporate changes that contemplate dealings with third parties at arm's length bargaining.

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*IND. CODE § 23-1-5-7 (1976).
*IND. CODE § 23-1-6-1 et seq. (1976).
*IND. CODE § 23-1-7-1 (1976).
*See note 20, supra, and accompanying text.
*A reverse stock split could be accomplished by an amendment to the articles of incorporation. See IND. CODE § 23-1-4-1 et seq. (1976), IND. CODE § 23-1-4-4 (Burns Supp. 1978).
*For an example of the application of a freeze-out reverse stock split see Clark v. Pattern Analysis & Recognition Corporation, 87 Misc.2d 385, 384 N.Y.S.2d 660 (1976), in which majority shareholders proposed a recapitalization plan that reduced outstanding shares on a ratio of 4000 to one. No provision was made for fractional shares other than purchase. The plaintiff minority, of course, owned less than 4000 shares. The court enjoined the plan for lack of a "strong and compelling corporate business purpose". *Contra*, Teschner v. Chicago Title & Trust Company, 59 Ill.2d 462, 322 N.E.2d 54 (1974).
So viewed, Gabhart establishes good law. Summary elimination of fellow shareholders from participation in an ongoing enterprise is normally beyond the acceptable purposes of the use of corporate control. If shareholders desire this power they should provide for it inter se from the onset of the shareholder relationship. Otherwise the use of such power is simply a demise of corporate norms that should not be made respectable by reference to statutory provisions.

Moreover, the type of transaction that took place in Gabhart would not seem to be a natural response of the corporate community in the resolution of their problems. On the contrary, the deployment of such a transaction is more likely to be the response of over-zealous counsel. Accordingly, business can continue under Gabhart.

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