Recent Developments in the Law of Corporate Freeze-Outs

Michael D. Malfitano
STUDENT COMMENTS

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One of the fundamental objectives of the federal securities laws, as expressed in section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), is the protection of investors and shareholders from fraudulent and manipulative securities transactions. This section and rule 10b-5 promulgated under it have become one of the most controversial and frequently discussed areas of securities law. Section 10(b) and rule 10b-5 have been applied by the Securities and Exchange Commission and by the federal courts to a wide variety of unfair practices by insiders, boards of directors, and controlling stockholders. Originally broad in scope, these provisions have undergone such extensive judicial expansion that it is now realistic to speak of a federal law of corporations supplementing, and in some instances substituting for, state corporation laws. Although the regulation of internal corporate affairs has traditionally been an area within the scope of state regulation, this judicial extension was spawned by a lack of effective remedies for unfair and deceptive practices in the purchase or sale of securities under existing state corporation laws.

One specific internal corporate problem to which section 10(b) and rule 10b-5 have increasingly been applied is the freezing out of minority shareholders by the controlling or majority shareholders.

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   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—...
   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2 17 C.F.R. 240.10b-5 (1972):
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.
   (a) To employ any device, scheme, or artifice to defraud,
   (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
   (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

5 The terms controlling shareholders, dominant shareholders, and majority shareholders will be used interchangeably throughout this comment to depict the dominant
A freeze-out, also called a squeeze-out, refers to the manipulation of corporate control to eliminate minority shareholders from a corporation, reduce their relative voting power to insignificance, or otherwise deprive them of the rights and privileges to which they, as shareholders, are entitled. A variety of methods have been used to accomplish freeze-outs. Some of the most common methods include merging the corporation into another corporation wholly-owned by the majority shareholders of the original company; selling the corporate assets to a company newly formed by the majority shareholders; issuing additional common stock, thereby diluting the voting strength of the minority shareholders; dissolving the corporation; and refusing to declare dividends. While most states provide an appraisal remedy for some of these corporate manipulations, rule 10b-5 has provided the possibility of a more effective remedy for the minority shareholder when the conditions for a cause of action under the rule have been met.

Two recent federal cases, Bryan v. Brock & Blevins Co. and Krafcisin v. LaSalle Madison Hotel Co., are representative of the continuing conflict in the freeze-out area and bring into focus the most recent phase of the expansion of 10b-5 into internal corporate affairs—an area traditionally governed by state law. In each case a minority shareholder brought suit in federal district court, alleging violation of section 10(b) and rule 10b-5 and seeking to enjoin structural corporate changes, which the majority shareholders were using to freeze him out. Despite the factual similarities, the courts used different reasoning to arrive at different conclusions as to the applicability of rule 10b-5 to the freeze-outs. The conflicting decisions in these cases are characteristic of a more general conflict over a long period of time with regard to how far rule 10b-5 should be judicially extended.

This comment will review the development of state laws dealing with unfair and deceptive conduct by majority shareholders aimed at minority interests. It will examine the development of section 10(b) and rule 10b-5 as they relate to such conduct, and the conflict between traditional federal and state law concepts. Finally, it will attempt to define the future scope of the interrelationship between federal and state corporation law in the area of freeze-outs based upon the Bryan decision.

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7 For an extensive discussion of the various freeze-out techniques and possible remedies, see F. O'Neal & J. Derwin, Expulsion or Oppression of Business Associates §§ 3.01-5.15 (1961); O'Neal, Oppugnancy and Oppression in Close Corporations: Remedies in America and in Britain, 1 B.C. Ind. & Com. L. Rev. 1 (1959).
8 These methods are discussed in F. O'Neal & J. Derwin, supra note 7, at 3.01-5.15.
9 See note 11 infra and accompanying text.
I. THE DEVELOPMENT OF STATE CORPORATION LAW

There has never been any agreement among state courts as to the duty, if any, owed by the majority or controlling shareholders of a corporation to the minority shareholders with respect to private transactions between them involving the corporation's shares. Two divergent schools of thought have developed. Most states, including all but a few of the less industrialized ones,12 traditionally imposed upon controlling shareholders a fiduciary obligation, but only toward the corporation itself or toward those acting on behalf of the corporation.13 Under this view the corporation was conceptualized as a separate legal entity, distinct from its shareholders. Thus, in the majority of jurisdictions, controlling shareholders were free to act in their own untrammelled self-interest when engaged in a private transaction with minority shareholders. A minority of jurisdictions took a contrary view, impressing upon majority shareholders a fiduciary duty to disclose to minority shareholders all material information relevant to any private transaction between them involving the corporation's stock.14

Even under the minority rule, however, courts had difficulty finding that a controlling shareholder had violated a fiduciary duty to the minority when the transaction was between the minority shareholder and the corporation itself.15 Consequently, where controlling shareholders were unable to persuade the unwanted minority shareholder to sell his shares in a private transaction, they frequently caused the corporation to undergo a structural change which resulted in the elimination of the minority interest. For example, the entire assets of the corporation would be sold to a newly formed corporation wholly-owned by the majority, and the consideration received would be distributed

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12 3 L. Loss, Securities Regulation 1446 n.4 (1961).
13 Id. at 1446.
14 See, e.g., Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903); Stewart v. Harris, 69 Kan. 498, 77 P. 277 (1904); 3 L. Loss, supra note 12, at 1447. In Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919), the New York Court of Appeals reversed the dismissal of a complaint which alleged that a dissolution was being used to freeze out the plaintiff (there being no appraisal right), holding that majority shareholders as well as directors were "burdened and restricted by fiduciary obligations" to minority shareholders. Id. at 195, 123 N.E. at 151. The Supreme Court of Washington, in Theis v. Spokane Falls Gaslight Co., 34 Wash. 23, 242 P. 1025 (1932), also enjoined a freeze-out by means of dissolution, stating that the state dissolution statute did not give the majority shareholder an absolute right to dissolve the corporation without a legitimate business reason, and that the minority shareholder had a right to retain his interest in the business. Id. at 30, 74 P. at 1006.
15 In Matteson v. Ziebarth, 40 Wash. 2d 286, 242 P.2d 1025 (1952), the court found a fiduciary duty, but held that the majority shareholder had not breached his fiduciary duty to the minority shareholder since there had been a complete disclosure of the facts involved in the merger and the merger was supported by a valid business purpose. The business purpose test as a standard of fiduciary duty, however, is a less stringent one than that applied in Kavanaugh. This distinction raises the issue of under what circumstances a majority shareholder is justified in forcing a minority shareholder out of the corporation against his will; see discussion in text at notes 83-84 infra.
in liquidation. Although substantially all the states require shareholder consent for such a change, the statutes typically provide for approval by two-thirds of the voting shares. Thus the minority shareholder was often helpless to prevent such a freeze-out.

In an attempt to mitigate any unfairness produced by such statutory provisions and to avoid the harsh effects of the majority rule respecting the fiduciary duty of controlling shareholders, most jurisdictions now afford a minority shareholder the opportunity to dissent from a proposed corporate change and receive an agreed upon sum or the appraised value of his shares in cash from the corporation. The theory upon which the right of appraisal is based is that no investor should be forced to remain as a shareholder in a corporation or business which is substantially different from that in which he originally invested. Although it has been argued that appraisal rights are unnecessary when a corporation's shares are publicly traded since one who no longer wishes to remain a shareholder can dispose of his shares through a broker at market value without the expenses or delays of litigation, such rights may indeed be important to the minority shareholder in a closely held corporation.

Appraisal, however, has proved for a number of reasons to be a rather unsatisfactory remedy for the minority shareholder being frozen out of his corporation. First, most states do not grant an appraisal right for every fundamental corporate structural change, especially for those changes which may be effected by the board of directors without shareholder approval. Second, the statutes of some states provide that

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19 See H. Ballantine, Corporations § 298 (rev. ed. 1946).
22 See Note, Freezing Out Minority Shareholders, 74 Harv. L. Rev. 1630, 1635 (1961). Most states provide appraisal upon consolidation or merger, while some states
where a right of appraisal exists, it shall be the dissenter's exclusive remedy, and courts in a few of these states have concluded that equitable relief is barred by implication. Third, the minority shareholder in a freeze-out situation is frequently not interested in getting the fair market value for his shares, but in remaining as a shareholder in the corporation with full rights of participation in its future earnings and appreciation in value. Fourth, in a close corporation situation, appraisal will often leave the minority shareholder with something less than the true value of his shares, force undesirable tax consequences upon him, or otherwise affect him adversely.

A compelling argument may be made that while the freedom of the controlling shareholders to manage the corporation ought not to be impinged, neither should a minority shareholder be forced to relinquish his interest in the corporation unless the proposed structural change has a genuine business purpose beyond a desire on the part of the majority to freeze him out. This reasoning has gained increasing approval, and many states—including some which previously held appraisal to be an exclusive remedy—now permit shareholders to sue in equity to enjoin a corporate action where bad faith or fraud can be shown. Such suits have been won by minority shareholders on an expanded fiduciary duty theory—i.e., a controlling shareholder, like a director, is, vis-à-vis the minority, in a position of trust with respect to

make it available for a sale of all or most of the assets of the corporation. See text at note 18 supra. Yet very few states provide appraisal for dissolution. The lack of consistency within the individual state statutes has been criticized, but it seems to be logical to distinguish between situations in which the minority shareholder receives a proportionate share of the proceeds from a sale of assets or a dissolution and liquidation on the one hand, and those structural changes in which he receives only an interest in a totally different organization than that he invested in on the other.


24 Blumner v. Federated Dept Stores, Inc., 99 N.Y.S.2d 691 (Sup. Ct. 1950); Gelger v. American Seeding Mach. Co., 124 Ohio St. 222, 177 N.E. 594 (1931). In Blumenthal v. Roosevelt Hotel, Inc., 202 Misc. 988, 115 N.Y.S.2d 52 (Sup. Ct. 1952), the court in effect said that where the appraisal remedy will provide the minority shareholder with the full value of his holdings in the company, a court would not enjoin the transaction even if the avowed purpose of the majority were to squeeze out the minority shareholder.

25 The right not to be locked into a corporation when it has undergone a fundamental change may arguably have an analog in a corresponding right to remain as a shareholder in a corporation which has undergone no such change or where a change takes place in form only.

26 See Vorenberg, supra note 21, at 1201-04.

27 Id. at 1204.


to all his dealings involving the corporation.\textsuperscript{30} The validity of this theory was asserted by the United States Supreme Court in the 1939 bankruptcy case of \textit{Pepper v. Litton}:\textsuperscript{31}

\begin{quote}
[A controlling shareholder] cannot use his power for his personal advantage and to the detriment of the stockholders . . . no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements.\textsuperscript{32}
\end{quote}

In characterizing the obligation of the majority as a position of trust, the Court imposed upon controlling shareholders the burden of proving that a given transaction was not only executed in good faith but was inherently fair.\textsuperscript{33}

A recently decided California case, \textit{Jones v. H.F. Ahmanson & Co.},\textsuperscript{34} adopted the reasoning of \textit{Pepper} and is indicative of an accelerating trend toward state court recognition of a fiduciary duty owed by the majority to minority shareholders.\textsuperscript{35} In \textit{Jones}, the majority shareholders exchanged their shares in a savings and loan association for a larger interest in a newly formed holding company. The assets of the savings and loan were then pledged to secure holding company debts. The scheme was to destroy the market value of plaintiff's shares and effectively disenfranchise her. The court, in a well-reasoned opinion, found this to be a breach of the majority's fiduciary duty to exercise control in an equitable manner,\textsuperscript{36} stating that:

\begin{quote}
The increasingly complex transactions of the business and financial communities demonstrate the inadequacy of the traditional theories of fiduciary obligation as tests of majority shareholder responsibility to the minority. These theories have failed to afford adequate protection to minority shareholders and particularly to those in closely held corporations whose disadvantageous and often precarious position renders them particularly vulnerable to the vagaries of the majority.\textsuperscript{37}
\end{quote}

\textsuperscript{30} At first, such suits were only allowed where "special facts" existed which could be held to give rise to a fiduciary duty, such as the controlling shareholder's inside position or his intimate knowledge of corporate affairs. 3 L. Loss, supra note 12, at 1447. More recently, the range of facts sufficient to constitute such special circumstances has been gradually expanded by the courts to the extent that a fiduciary duty on the part of the majority may be said to exist in virtually all situations involving transactions in the corporation's stock, whether they act in their capacity as shareholders or through directors or officers whom they control. Id. at 1447-48.

\textsuperscript{31} 308 U.S. 295 (1939).

\textsuperscript{32} Id. at 311.

\textsuperscript{33} Id. at 306.

\textsuperscript{34} 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969), noted in 70 Colum. L. Rev. 1079 (1970) and 83 Harv. L. Rev. 1904 (1970).

\textsuperscript{35} Cf. F. O'Neal, supra note 6, at 45.

\textsuperscript{36} 1 Cal. 3d at 108, 460 P.2d at 471, 81 Cal. Rptr. at 599.

\textsuperscript{37} Id. at 111, 460 P.2d at 473, 81 Cal. Rptr. at 601.
Widespread adoption by states of a fiduciary duty rule for majority shareholders gives rise to a potential conflict between state corporation law and federal securities law relating to unfair and deceptive practice in stock transactions. The federal law, particularly section 10(b) of the Exchange Act, was enacted for the purpose of protecting investors from fraudulent securities transactions—an area in which state laws were considered to be inadequate at the time. The federal statute was not, however, intended to preempt complementary state corporation law, but merely to establish concurrent jurisdiction. At a time when most state courts would grant injunctive relief from a corporate freeze-out only if common law fraud was involved, section 10(b) offered an attractive alternative to minority shareholders experiencing a freeze-out. Originally broad in scope, section 10(b) and rule 10b-5 have undergone a most extensive judicial expansion. Perhaps it is partly in response to this expansion and a corresponding fear that federal law would supplant state jurisdiction over an important aspect of corporate affairs: that state courts have become increasingly protective of the rights of investors, especially minority shareholders, in stock transactions. Nevertheless, the continued expansion of the federal remedy and its availability to freeze-out victims has prevented the resurgence of state court suits to enjoin freeze-outs, and assured federal pre-eminence as the protector of the minority shareholder. Whether the federal courts will retain this position is open to question. The Krafcsin and Bryan cases represent contradictory views in the latest attempt of the federal courts to answer this question.

II. THE EVOLUTION OF FEDERAL CORPORATION LAW IN RELATION TO FREEZE-OUTS

A. Early Development of 10b-5

The antifraud provisions of the Exchange Act were intended by Congress to be a major weapon in the drive to eliminate the widespread...
abuses in the securities markets that existed in the early 1930's.\textsuperscript{44} Prior to its passage, the only remedy a defrauded shareholder had was an action at common law for deceit. To support such a cause of action, it was necessary for a plaintiff to prove that (1) a false representation of fact had been made by the defendant,\textsuperscript{45} (2) the defendant knew that the representation was false and intended to deceive the plaintiff (scienter), and (3) the plaintiff reasonably relied on the representation to his injury.\textsuperscript{46} It was intended that section 10(b) be liberally construed\textsuperscript{47} and "free of the ancient and illogical distinctions that . . . haunted state fraud law."\textsuperscript{48} Nevertheless, even after the implementation of section 10(b) through promulgation of rule 10b-5, there was substantial uncertainty as to whether the standard of fraud under the rule was any different from the standard of common law fraud.\textsuperscript{49} The courts, however, in interpreting 10(b) broadly so as to prevent the frustration of its purpose, have developed standards of fraud and deceit less restrictive than those of the common law.\textsuperscript{50}

In adjudicating disputes under section 10(b) and rule 10b-5, the threshold question faced by the courts was whether private rights of action were to be permitted. In spite of the absence of a specific provision in section 10(b) for a civil action by a private individual, and the fact that other sections of the securities laws do provide for private remedies,\textsuperscript{51} the federal courts have consistently held that a private right of action is implied by section 10(b).\textsuperscript{52} To establish a cause of


\textsuperscript{45} Some cases have held that a concealment amounting to a false or misleading representation is sufficient to satisfy the first element. See, e.g., Brainerd Dispatch Newspaper Co. v. County of Crow Wing, 196 Minn. 194, 196, 264 N.W. 779, 780 (1936). Other cases suggest that the false representation must involve a breach of equitable or legal duty. See Coppo v. Coppo, 163 Misc. 249, 252, 297 N.Y.S. 744, 750 (Sup. Ct. 1937); Howard v. West Jersey & S.S.R. Co., 141 A. 755, 757 (N.J. Eq. 1928).

\textsuperscript{46} Restatement of Torts 537 (1938); W. Prosser, Law of Torts 686 (4th ed. 1971).

\textsuperscript{47} 3 L. Loss, supra note 12, at 1435.

\textsuperscript{48} Fleischer, supra note 3, at 1175.


\textsuperscript{50} See, e.g., Speed v. Transamerica Corp., 99 F. Supp. 808, 831 (D. Del. 1951) (citing cases); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 185-86, 195 (1963). In applying these standards, the courts have generally taken into account the relative sophistication of the parties involved in the transaction. Kohler v. Kohler Co., 319 F.2d 634, 641-42 (7th Cir. 1963). For a detailed discussion of the relationship between common law deceit and 10b-5 fraud, see 3 L. Loss, supra note 12, at 1430-44.


\textsuperscript{52} Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1940). For a criticism of this judicial creation of a private right of action, see Ruder, Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5, 59 Nw. U.L. Rev. 185 (1964). The Supreme Court, however,
action under rule 10b-5, the courts initially required plaintiffs to prove that (1) the defendant made use of the mails or other instrumentality of interstate commerce, (2) the defendant made a false or misleading representation or omission of a material fact, (3) such statement or omission was in connection with a transaction in which the plaintiff was a purchaser or seller of stock; (4) the defendant was in a relationship of privity with the plaintiff; (5) plaintiff relied on the misrepresentation, and (6) the misrepresentation caused the plaintiff's injury.50

Gradually each of these elements has undergone expansion or erosion at the hands of the federal courts. Plaintiffs bringing an action under section 10(b) have had little trouble satisfying the first of these requirements, relating to the use of an instrumentality of interstate commerce, since use of the mails or telephone in some aspect of the transaction occurs in almost every instance.51 The second requirement, that the defendant have made an untrue statement of a material fact or have omitted to state a material fact necessary in order to make the statements made not misleading, would seem to suggest that some statement on the part of the defendant is required. However, the courts have found that a complete nondisclosure can also constitute a prohibited misrepresentation if it relates to a material fact which would affect the value of the stock or the judgment of the plaintiff as to whether or not to purchase or sell his stock.52 The third requirement—that the misrepresentation be in connection with the purchase or sale of stock—has been interpreted very liberally by the courts. In the context of a freeze-out, the concept of a sale has been extended to include any

54 The easy satisfaction of the jurisdictional requirements stems from the fact that the misrepresentation does not have to be transmitted through the mail or interstate commerce. Any connection between the jurisdictional means and the misrepresentation is sufficient for 10b-5 purposes. See Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967); Errion v. Connell, 236 F.2d 447 (9th Cir. 1956); Fratt v. Robinson, 203 F.2d 672 (9th Cir. 1953).
fundamental corporate structural change such as a merger or dissolution, in which a shareholder is forced, by a state appraisal statute or otherwise, to relinquish his stock for a sum of money.\(^{60}\) Closely related to the purchase or sale of stock requirement is the requirement that there must be privity between the plaintiff and defendant. While it was clear that such a relationship existed where one was buying shares sold by the other in a direct transaction between the two, this relationship has since been found to be unnecessary where shares are simply traded by plaintiff on a securities exchange.\(^{61}\) The fifth element originally required that the plaintiff have reasonably relied on the misrepresentations made by the defendant. However, the acceptance by the courts of nondisclosure as violative of 10b-5 necessitated a more flexible treatment, since a plaintiff could not logically rely upon a misrepresentation where none was made.\(^{62}\) As a result, the reliance requirement was gradually merged into the final requirement—causation.\(^{63}\) The result of this merger is that a plaintiff need no longer prove that he relied on a false representation, but simply that the deception in some way caused his injury. The requirement that a causal connection be shown between the misrepresentation and the plaintiff's injury, however, has remained as the major obstacle to plaintiffs seeking relief from a corporate freeze-out.

In *Krafcisin* and *Bryan*, the question was raised by each plaintiff whether, at least in some situations, a minority shareholder may invoke section 10(b) and rule 10b-5 even though there is no causal relationship between the manipulation connected with a corporate merger or dissolution and his injury by reason of the loss of his share of ownership in the company by the forced sale of his stock. The plaintiffs argued that a duty is owed by the majority to the minority shareholders not to freeze them out of the corporation, violation of which is, even absent causation,\(^{64}\) sufficient to create a cause of action.

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63 Id. at 1373.

64 The causation referred to here, and throughout this comment, is the proximate
under 10b-5. The positions taken by the Krafcisin and Bryan courts are indicative of the significant degree of conflict on this question. Considered together, they represent one of the frontiers of the extension of section 10(b) and rule 10b-5 toward the establishment of a federal fiduciary duty.

B. Krafcisin and Bryan: Causation and the Federal Fiduciary Duty Under Rule 10b-5

Krafcisin v. LaSalle Madison Hotel Co. and Bryan v. Brock & Blevins Co. presented similar facts. In each case a minority shareholder brought suit in federal district court under section 10(b) of the Exchange Act and rule 10b-5 to enjoin corporate structural changes allegedly designed by the majority shareholders to eliminate the minority's interest in the corporation. Despite the factual similarities, the District Court for the Northern District of Georgia and the District Court for the Northern District of Illinois followed different lines of reasoning and arrived at different conclusions.

In Krafcisin, the defendant majority shareholders gave the plaintiff notice of a special shareholders' meeting to be held for the purpose of considering voluntary dissolution of the company. The plan of liquidation adopted by the majority provided for a distribution of the corporate assets in which Krafcisin was to receive a cash payment and the defendants were to receive property. The plaintiff alleged that the underlying motive for the proposed dissolution was to freeze him.

causation which is an element of a 10b-5 action. This is to be distinguished from the causal relationship between the breach of the duty claimed to exist by the plaintiffs in Krafcisin and Bryan and the injury to them.


In Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947), the court reversed the dismissal of an action for damages brought by minority shareholders who were deceived into redeeming their shares for a price below what they would have received in the forthcoming but undisclosed liquidation planned by the majority. The court found that under federal law, a majority stockholder occupies a fiduciary relation towards the minority stockholders, and is charged with the duty of exercising a high degree of good faith, care, and diligence for the protection of such minority interests. Every act in [the majority's] own interest to the detriment of the holders of minority stock becomes a breach of duty and of trust, and entitles to [sic] plenary relief from a court of equity.

The court based this holding on several early federal cases which had imposed such a duty on the majority; e.g., Southern Pac. Co. v. Bogert, 250 U.S. 483, 487-88 (1919); Hyams v. Calumet & Hecla Mining Co., 221 F. 529, 537 (6th Cir. 1915). Since the complaint in Zahn did not allege violations of the federal securities laws, and since the cases cited by the court were decided prior to Erie v. Tompkins, 304 U.S. 64 (1938), the holding was apparently grounded in the old federal common law which should no longer have been applicable in view of Erie and the passage of the Securities Act of 1933 and the Exchange Act. Thus, it is apparent that there is no federal common law fiduciary duty.

out of the corporation, that the defendants did not reveal this purpose
in the notice to shareholders, and that the defendants attempted to
deter him from opposing the plan of liquidation by falsely representing
that the amount of cash to be paid for each of his shares exceeded the
per share value of the property to be distributed to the majority for
their shares. 68

The court granted the defendants’ motion to dismiss the complaint
for failure to state a claim upon which relief could be granted under
section 10(b) and rule 10b-5. It reasoned that it was not necessary
for the defendants to have informed Krafcisin of their intention to
freeze him out since the proposed dissolution should have put him on
notice that he might have to relinquish his shares. 69 In addition the
court found that Krafcisin’s receipt of a lower price for his shares was
not in itself sufficient to show that the plan of liquidation was inequi-
table. With regard to the alleged misrepresentation, the court concluded
that even if this had been a violation of 10b-5, Krafcisin lacked stand-
ing to raise that issue since there was no causal relationship between the
misrepresentation and the injury claimed. 70 The court reasoned that
since the defendants owned ninety-six percent of the stock of the
corporation, they could have effected a voluntary dissolution under the
Illinois Business Corporation Statute 71 regardless of the opposition of
Krafcisin or the state of his knowledge. 72 Thus, the court held that
Krafcisin had suffered no injury cognizable under section 10(b) or
rule 10b-5. Implied in the decision was a holding that rule 10b-5 will
not protect a minority shareholder from a corporate freeze-out where
the freeze-out is accomplished by a corporate action authorized by
state law.

In Bryan, the plaintiff owned fifteen percent of the stock of Brock &
Blevins and had, until his resignation, been an employee and director
of the company. Shortly after his resignation, the majority shareholders
attempted to buy Bryan out, threatening to acquire his shares forcibly
by effecting a fundamental corporate change if he refused to sell. 73
Bryan declined to relinquish his stock because he considered the price
offered for his shares to be less than their actual value. 74 Subsequently,
the other shareholders of Brock & Blevins formed a new corporation,
Power Erectors, Inc., and excluded Bryan from participation in the
new company. 75 These shareholders, constituting all of the directors
and shareholders of the new corporation, next exchanged their Brock &
Blevins stock for Power Erectors stock, making Power Erectors the

68 Id. at 92,729.
69 Id. at 92,728-29.
70 Id. at 92,729.
71 Ill. Ann. Stat. ch. 32, § 157.76(c) (Smith-Hurd 1954) requires the approval of
two-thirds of the outstanding voting shares to effect a voluntary dissolution.
73 343 F. Supp. at 1065.
74 Id.
75 Id.
owner of eighty-five percent of Brock & Blevins. They then began proceedings to merge Brock & Blevins into Power Erectors. Under the plan of merger, the eighty-five percent of the Brock & Blevins stock owned by Power Erectors was to be cancelled, and Bryan was to receive a cash amount for his stock, thus eliminating Bryan from all ownership rights.  

The court permanently enjoined the merger of the two companies, holding that the actions of the majority shareholders were fraudulent and deceptive acts violative of section 10(b) and rule 10b-5. The injunction issued in spite of the fact that, as in Krafcisin, the minority shareholder was powerless under state law to prevent the merger. The applicable Georgia statute provided for a merger upon approval of a majority of the voting shares, and the majority owned eighty-five percent of the Brock & Blevins stock. The decision was based on the failure of the majority to disclose to Bryan the probability of a public offering of securities by the company in the near future, an error in the income statement used in the valuation of his stock, and the existence of an intention and a plan to freeze Bryan out of the company. But the court makes it reasonably clear that the last ground alone would have provided a sufficient basis to enjoin the merger. The implication here, contrary to that in Krafcisin, was that rule 10b-5 may be applied to enjoin the freeze-out of a minority shareholder regardless of whether the method employed is a structural change permitted by state law.

Thus, the narrow but important point on which the two district courts disagreed is whether and to what extent rule 10b-5 may be invoked by minority shareholders to prevent a freeze-out by the majority where the mechanics of the corporate device used are sanctioned under state law. The approaches of these two courts to this question, the decisions rendered and the rationale therefor may be a key to gauging the propensity of some federal courts to further extend section 10(b) and rule 10b-5 into the area of internal corporate affairs—an area traditionally governed by state law.

At the outset, the two courts have an apparently irreconcilable conceptual disagreement. The Krafcisin court believes that a minority shareholder has no absolute right to retain ownership in a corporation when the majority shareholders wish to eliminate him. The Bryan court believes that a corporate majority has no right to exclude a

76 Id. at 1066.
77 Id. at 1070.
79 343 F. Supp. at 1069.
80 Id. at 1066.
81 Id. at 1070.
82 Id.: "The proposed merger itself was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock." (Emphasis added.)
minority shareholder from continued ownership against his will unless there is a "plausible business purpose" for such action. This theoretical difference is reflected most directly in the courts' legal analyses of the causation requirement in a 10b-5 action. To fully appreciate the complexities and ramifications of these analyses, some historical background is necessary.

In all of the early 10b-5 cases, before a plaintiff could recover, he was required to show that a causal connection existed between some misrepresentation, omission or other deceptive device alleged and the injury complained of. This requirement was closely related to the buyer-seller and reliance requirements; i.e., if the plaintiff could not show that he had purchased or sold securities in reliance on the misrepresentation, such misrepresentation could not have caused his injury. These requirements made it especially difficult for a minority shareholder victimized by a freeze-out in the form of a merger or liquidation to remain in federal court beyond the preliminary stages of his case.

Seven years before Krafcisin and Bryan, a case arose in the Southern District of New York involving the freeze-out of a minority shareholder. In Barnett v. Anaconda Co., the minority shareholder sued to enjoin a sale of assets and corporate dissolution on the ground that deceptions and misrepresentations contained in the proxy statement violated sections 10(b) and 14(a) of the Exchange Act. The court dismissed the claim, finding the element of causation, necessary to sustain the action under either section, to be lacking. The court noted that since the controlling shareholder owned seventy-three percent of the stock of the corporation, he had the power to effect a merger under state law. Any misrepresentations could not, therefore, have caused the plaintiff's injury, the court reasoned, since the minority shareholder could not have prevented the dissolution by any "internal corporate procedures." Under this rationale, a minority shareholder who acceded to a dissolution because he was misled by misrepresentations made by the majority could not recover where the only alternative available to him, had he known the true facts, would have been such external actions as a state court injunctive suit or public exposure of

87 One difficulty with these early 10b-5 cases is the failure of the courts to indicate the specific factors on which their decisions turned, i.e., the existence or non-existence of appraisal rights; a misrepresentation or nondisclosure by the defendant; the absence of causation; the absence of reliance; etc.
90 238 F. Supp. at 776 (emphasis added).
the scheme in order to shame the majority into abandoning it.\textsuperscript{91} In effect, the court established the availability of such internal corporate procedures to combat a corporate structural change taking place under state corporation law as a standard or test to determine whether the element of causation was present. The internal-corporate-procedures test achieved only a very limited acceptance,\textsuperscript{92} however, and was seldom followed until the \textit{Krafcisin} court, without citing \textit{Barnett}, adopted that case's rationale.

In 1966, only one year after \textit{Barnett}, a case in the Eastern District of New York, \textit{Laurenzano v. Einbender},\textsuperscript{93} presented similar facts. The plaintiff minority shareholder sued on behalf of himself and the corporation to enjoin a corporate structural change on the ground that the proxy solicitation made in connection with the transaction was false and misleading. The defendant majority shareholders responded with the \textit{Barnett} argument that since they owned a controlling interest sufficient to ensure approval of the proposed transaction without the votes of any potential dissenter who might have been deceived by the proxy statement, a defective proxy could not be the legal cause of the plaintiff's injury. The court, however, found that a shareholders' meeting and vote required by law does not become "nugatory and dispensable because one stockholder owns enough shares to carry any resolution and can be expected to vote in favor of his own resolutions."\textsuperscript{94} The result of the meeting was not a legal conclusion, stated the court, nor was it impossible that an unfavorable vote by the minority might bring about a modification or reconsideration of the transaction—"in corporate circles, consensus can be a desideratum."\textsuperscript{95} Based on this reasoning, the court denied the defendants' motion for dismissal, holding that if the plaintiff could prove the proxy statement misleading, the validity of the meeting would be destroyed and a causal relationship between the misrepresentations and plaintiff's injury would be clearly established.\textsuperscript{96} Thus, while it did not reject the internal-corporate-procedures test of \textit{Barnett}, the court clearly disagreed with \textit{Barnett}'s characterization of a shareholders' meeting as being "unavailable" as a remedy to minority shareholders where the majority controlled sufficient votes to ensure approval of the challenged transaction.\textsuperscript{97} The


\textsuperscript{93} 264 F. Supp. 356 (E.D.N.Y. 1966).

\textsuperscript{94} Id. at 362.

\textsuperscript{95} Id. at 361.

\textsuperscript{96} Id. at 362. At the trial on the merits, the district court found that the proxy statement was not misleading and dismissed the complaint. The dismissal was subsequently upheld by the Second Circuit. Laurenzano v. Einbender, 448 F.2d 1 (2d Cir. 1971).

\textsuperscript{97} At the end of its decision, the court asserts, without elaboration, that List v.
idea that minority shareholders are entitled to full disclosure even where no intracorporate remedies are available to them is not new—indeed, the conceptual underpinning of the disclosure provisions of the Exchange Act is that full public disclosure will itself deter and prevent corporate misdealing.98

One year after Laurenzano, the Southern District of New York decided the case of Entel v. Allen.99 The plaintiffs sought an injunction, alleging that the transaction contemplated by the majority constituted a fraudulent scheme which violated their fiduciary duty under state corporation law. Had the details of the proposed transaction been fully disclosed to the minority, they argued, a state court action could have been brought to enjoin the plan. The court held that where minority shareholders did not exercise their state law right to object to a corporate structural change because they were deceived by a proxy statement containing omissions and misleading information, a cause of action exists under section 10(b) and rule 10b-5.100 The Entel case is significant for two reasons. First, in finding the loss of an extra-corporate remedy to be a sufficient causal connection to the plaintiff's alleged injury to sustain an action under 10b-5, it apparently abandoned the internal-corporate-procedures test of causation laid down in Barnett. Second, it implied that a scheme to breach a state-imposed fiduciary duty to a minority shareholder, if undisclosed, might also constitute a violation of federal law.101

A more direct repudiation of the Barnett rationale was effected by the Seventh Circuit in an even more recent case, Swanson v. American Consumer Industries, Inc.,102 where the 10b-5 action of a minority

Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965), "would appear to preclude a section 10(b) and rule 10b-5 claim distinct from a section 14 claim in the precise factual situation here presented." 264 F. Supp. at 362. The basis for such a distinction by the court is unclear. In List, the plaintiff's complaint was dismissed because the court found that the plaintiff's action was not affected by the alleged failure to disclose information. Thus, the elements of materiality and reliance were lacking. However, if the court felt that a plaintiff's inability to prevent a transaction meant that no information either misrepresented or undisclosed could be "material" to him within the meaning of rule 10b-5, it is difficult to see why this would not also destroy the materiality of the misrepresentation under rule 14a-9. Further, although the court in List found that the plaintiff's injury could not have been caused by the alleged misrepresentation since he did not rely on it, the Laurenzano court did find that proving a misrepresentation in the proxy statement would establish a causal relationship between it and the plaintiff's injury.

98 See, e.g., In the Matter of Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961): "If . . . disclosure prior to effecting a purchase or sale would be improper or unrealistic under the circumstances, we believe the alternative is to forego the transaction."


100 Id. at 70 (Memorandum on Motion to Reargue). The court, believing such an extension of section 10(b) and rule 10b-5 should best be left to Congress, reluctantly adopted its position in Entel, having been overruled twice in the previous six months in cases where it attempted to limit the scope of the rule. See Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir. 1967), rev'd 352 F. Supp. 212 (S.D.N.Y. 1966); A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967), rev'd the unreported district court decision.

101 270 F. Supp. at 70.

102 415 F.2d 1316 (7th Cir. 1969).
shareholder to prevent a freeze-out based on an allegedly deceptive proxy statement was allowed despite the ownership by the majority of eighty-seven percent of the stock.\textsuperscript{103} Although the Swanson holding was based on Laurenzano, the decision was also placed on public policy grounds. The court reasoned that mechanical application of the internal-corporate-procedures test would lead to approval of all types of fraudulent conduct against minority shareholders by controlling shareholders who held a sufficient number of votes to approve corporate structural changes under state law.\textsuperscript{104}

In Krafcisin the district court ignored these later cases in adopting the old Barnett rationale. In spite of Laurenzano, the court rejected as an exercise in futility plaintiff’s claim that, had he not been deceived by the misrepresentations and omissions of the majority, he might have been able to bring pressure on the majority to abandon the dissolution and freeze-out by publicizing the inequity of the transaction. In spite of Entel, the court rejected the plaintiff’s claim that the possibility of a state court action to enjoin the freeze-out, had the scheme been fully disclosed, was sufficient to establish causation. The Swanson case was distinguished strictly on Barnett reasoning, the court noting that the proposed transaction in Swanson was a sale of the corporate assets and a misrepresentation could have dissuaded the plaintiff from asserting his appraisal rights (an internal corporate procedure), whereas in Krafcisin no such rights existed.\textsuperscript{105}

The only positive note sounded by the Krafcisin court for minority freeze-out victims was some dicta in the case suggesting that the court may be willing, in some situations, to find a causal relationship between a plaintiff’s injury and a deceptive act by the majority where the deceptive act prevents or deters the plaintiff from the timely assertion of a state law right against the transaction. It is not clear, however, what sort of situation would fit the court’s requirements.

In Bryan, the district court approached the question of causation more cautiously, looking first to whether the alleged deceptive acts of the defendant had caused the plaintiff’s injury by inducing him to buy or sell shares in reliance thereon. It thus recognized the inter-dependency of the elements of a 10b-5 cause of action. Cases such as Barnett, Laurenzano and Entel had not needed to consider the buyer-seller issue since the alleged misrepresentations occurred in the context of a proxy statement and section 14(a) and rule 14a-9 establish no buyer-seller requirement.\textsuperscript{106}

Because of this felt need to identify the plaintiff as a buyer or

\textsuperscript{103} Id. at 1331-32.
\textsuperscript{104} Id. at 1331.
\textsuperscript{106} With the exception of the buyer-seller requirement, however, rules 14a-9 and 10b-5 impose an identical standard of conduct in regard to false misrepresentations in connection with the sale of stock. See 17 C.F.R. §§ 240.14a-9(a), 10b-5(b) (1972).
seller of shares, the first case the Bryan court looked to was Vine v. Beneficial Finance Co.,\textsuperscript{107} where the Second Circuit held that a minority shareholder forced to relinquish his shares by reason of a merger of his corporation into another was a "forced seller" and therefore entitled to sue under rule 10b-5. The Vine court found causation to be present by reason of the fact that, although the plaintiff did not tender his shares in reliance on the alleged misrepresentations made by the defendant, a sufficient number of other shareholders did so to give the defendant sufficient control to effect the merger over plaintiff's objection.\textsuperscript{108} Significantly, the defendant did not have sufficient control to ensure approval of the merger prior to the tender offer containing the alleged violation.

The rationale of Vine was picked up by the Fifth Circuit and extended in Dudley v. Southeastern Factor & Finance Corp.,\textsuperscript{109} involving a freeze-out scheme utilizing a corporate liquidation and dissolution. The court adopted the reasoning of Vine, stating: "[A] shareholder should be treated as a seller when the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares."\textsuperscript{110} The Fifth Circuit then held that the plaintiff had stated a cause of action under 10b-5 merely by alleging the existence of a fraudulent and manipulative scheme which had the effect of converting him into a forced seller.\textsuperscript{111}

Apparently, no allegation of misrepresentation or nondisclosure on the part of the defendant was necessary. No mention was made of causation, although the court may have assumed that the fraudulent scheme which converted the plaintiff into a forced seller was the cause of the plaintiff's injury. If no misrepresentation was necessary where a scheme to defraud existed, the only question inadequately answered by Dudley was the meaning to be given to the term "defraud" in applying 10b-5. While fraud in securities transactions had, for the most part, been difficult to prove in many state courts, some federal courts have apparently used it to mean simply "do something bad to."\textsuperscript{112}

The Bryan decision represents a further extension of the Dudley reasoning with respect to the application of rule 10b-5, and posits an interesting definition for "fraud." In Bryan, the Northern District of Georgia quickly jumped the reliance and causation hurdles, saying that "[a]ny manipulative or deceptive device or contrivance which would cause a reasonable investor to rely thereon is meant to be outlawed."\textsuperscript{113}

\begin{thebibliography}{112}
\bibitem{107} 374 F.2d 627 (2d Cir. 1967).
\bibitem{108} Id. at 635.
\bibitem{109} 446 F.2d 303 (5th Cir. 1971).
\bibitem{110} Id. at 307.
\bibitem{111} Id. at 308. Although the plaintiff did allege that the manipulative scheme took place without his knowledge, this is substantially different from an allegation of misrepresentation or nondisclosure of a material fact.
\bibitem{112} See R. Jennings and H. Marsh, supra note 92, at 1225 & n.18.
\bibitem{113} 343 F. Supp. at 1069.
\end{thebibliography}
It found certain misrepresentations were made by the majority, but clearly stated that there would still be a 10b-5 violation if the acts of the majority themselves constituted fraud. Presumably the decision would have been the same whether or not the defendants had made the misrepresentations which they argued were irrelevant by reason of their eighty-five percent ownership. In defining fraud under 10b-5, however, the court did not have in mind the elements of common law fraud, but instead referred to a breach of the fiduciary duty owed by a majority or dominant shareholder to his corporation as set forth by the Supreme Court in Pepper v. Litton.\textsuperscript{114} The court proceeded to extend this fiduciary duty of the majority to minority shareholders, and in effect transformed the traditional elements of a 10b-5 violation —a materially deceptive act, reliance, and causation—into a much broader prohibition of any manipulative act which would constitute a breach of this duty. Such an approach renders the requirement of misrepresentation causally connected to the plaintiff’s injury unnecessary. The court did not need to go as far as it did. Having found a material nondisclosure, the court could have found such omission to be the cause of the plaintiff’s injury. Since the transaction in question was a merger giving the plaintiff an appraisal right, Bryan, like the Swanson case, could have been easily distinguished from Krafcisin, which involved a dissolution with no such appraisal right. However, the court chose not to rest its decision on this ground. Instead the court went beyond Dudley, holding that the formation of the new corporation “was a device, scheme, or artifice to defraud Bryan of his stock” and that “[t]he proposed merger itself was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock.”\textsuperscript{115} Thus, the court seemed to be saying that the very formulation and execution of a plan to freeze-out a minority shareholder, if unsupported by some reasonable business purpose, is itself sufficient to breach the fiduciary duty to the minority imposed upon majority shareholders under rule 10b-5.

If this interpretation of the Bryan decision is correct, it represents a significant extension of prior 10b-5 concepts and creates a federal fiduciary duty under subsections (a) and (c) of the rule not hitherto recognized except under state law.\textsuperscript{116} The adoption of the Pepper standard of fiduciary duty as the standard of loyalty owed by majority to minority shareholders brings the Bryan court into the mainstream of the trend of state law acceptance of a majority shareholder’s fiduciary duty to the minority, and has significant implications for the future of the federal law of corporations.

\textsuperscript{114} 308 U.S. 295 (1939).
\textsuperscript{115} 343 F. Supp. at 1070.
\textsuperscript{116} The Pepper v. Litton standard was also used by the California Supreme Court in defining the common law duty owed by a majority shareholder to the minority in Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 108, 460 P.2d 464, 471, 81 Cal. Rptr. 592, 599 (1969). See discussion in text at notes 34-36 supra.
The Bryan decision, if generally followed by the federal courts, will be the precursor of several very significant developments in the law of corporations. First, Bryan established that, in a freeze-out situation, even if the majority shareholders have a sufficient awareness of the law to avoid making any misrepresentations or failing to disclose any material information, utilization of the freeze-out scheme in itself is sufficient to breach the majority's fiduciary duty to the minority shareholder which is embodied in rule 10b-5. Indeed, 10b-5 would seem to be applicable even though the minority shareholder realized or was told that the majority's purpose in executing the structural change was to freeze him out. Bryan himself was warned that such structural changes would be instituted if he refused to sell his stock to the majority. Criticisms of this development may center on the fact that the purpose of section 10(b) and rule 10b-5 has been accomplished once full disclosure has been made. However, a more basic purpose of the section has been characterized differently from that of mere disclosure: "Subsection 10(b) authorizes the Commission by rules and regulations to prohibit or regulate the use of any other manipulative or deceptive practices which it finds detrimental to the interest of the investor." If this is recognized by the courts as the more fundamental objective of 10(b), it is not illogical for a court to find a violation of 10b-5 even though the plaintiff knew he was being frozen out.

A second development emanating from the Bryan decision is the clarification of the law in regard to the standard of unfairness necessary for a 10b-5 violation. It was commonly understood when 10b-5 was promulgated that the elements of common law fraud would not be necessary to establish a cause of action under the rule, but exactly how much less than common law fraud would suffice has not been conclusively established. The Bryan court determined the standard of loyalty owed by majority or controlling shareholders to the minority to be that of a fiduciary relationship—extending beyond mere disclosure. If the Bryan standard is generally accepted by the federal courts, it will mark the creation of a federal fiduciary duty which will greatly expand the scope of the rapidly growing federal corporation law.

The third development represented by Bryan is that the establishment of a federally recognized fiduciary duty of majority share-
holders to minority shareholders places the federal law of corporations on a parallel course with the trend of development of the standard of loyalty between majority and minority shareholders under state law. This contemporaneous development of both federal and state law toward a fiduciary duty standard is indicative of an increasing willingness on the part of the courts to protect small shareholders from manipulation by dominant or controlling shareholders. Also, it is an arguable indication of a redefinition of the traditional boundaries between the spheres of corporate law regulated by the state and federal governments. Most fundamentally, the widespread acceptance of the fiduciary duty of majority to minority shareholders seems to indicate an increasing recognition of the right—either federally or state protected—of a shareholder not to be deprived of his property interest in the corporation at the whim of the majority.

The practical implications of the developments represented by the Bryan decision will be of great importance for both controlling and minority shareholders. If Bryan is followed, a minority shareholder will be easily able to defeat a freeze-out unless the majority has a valid business purpose. Perhaps more importantly, the controlling shareholder will have the burden of proving the existence of such a business purpose. As a net result, it will probably be significantly more difficult to execute a successful freeze-out in the future. Further, in combatting a freeze-out, a shareholder will be confronted with the choice of proceeding in either state or federal court. Prior to the advent of the trend in the state courts to impose a fiduciary duty on majority shareholders toward the minority, 10b-5 was obviously a more attractive remedy. The widespread acceptance of the fiduciary duty standard by the states, however, would seem to limit the attractiveness of 10b-5, particularly as it was applied before the Bryan decision. Indeed, the existence of a broad state remedy would seem to call into question the need for a federal remedy, especially since the regulation of internal corporate affairs traditionally has been within the ambit of state law. Three factors, however, will militate against a decrease in reliance on a 10b-5 remedy by freeze-out victims. First, although the acceptance of the fiduciary duty standard by the states has been widespread, not every state has moved in that direction.

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123 See discussion of state law in text at notes 27-37 supra.
124 The Bryan court, in adopting the fiduciary duty standard from Pepper v. Litton, also quoted with approval the language of the Supreme Court in Pepper imposing the burden of proof of fairness on the controlling shareholder. 343 F. Supp. at 1068.
125 See text at note 39 supra.
126 The traditional requirements under 10b-5—misrepresentation, materiality, reliance, causation, and a purchase or sale of securities—would, in a given case, be harder to establish by the plaintiff than a lack of inherent fairness in the transaction, which would be the standard in a state court applying the fiduciary duty rule.
127 See text at note 3 supra. See also Fleischer, Federal Corporation Law—An Assessment, 78 Harv. L. Rev. 1146 (1965).
128 Illinois appears to be one of the states that has not yet abandoned the “fraud” standard for a fiduciary standard of loyalty by the majority shareholders to the minority.
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Barring actual fraud, this leaves 10b-5 as the only viable remedy for freeze-outs in some states. Second, the Bryan decision has extended 10b-5 to the point that it offers at least as broad a scope of protection as the common law fiduciary duty standard. The third and perhaps decisive factor is that a plaintiff who brings an action under 10b-5 will enjoy several procedural advantages over one who sues in state court. Such advantages include nationwide service of process, less restrictive venue, the possibility that the plaintiff would be able to bring any state claims into the action under the doctrine of pendant jurisdiction, and broader discovery rules under the federal law. As a result of these advantages, it seems likely that 10b-5 will remain a viable alternative to state court actions as a remedy for corporate freeze-outs.

CONCLUSION

Though the broad expansion of rule 10b-5 which Bryan effected will undoubtedly be criticized as an improvident judicial extension, the Bryan decision may be the precursor of a significant development of the federal law of corporations. Moreover, this trend is necessary in order to keep pace with development of sentiment in the state courts and in society generally to offer greater protection against the victimization of those who are in a less powerful economic position than others. The Bryan interpretation imposes on majority shareholders a far greater duty of loyalty to the minority than the majority previously had under 10b-5, at least with regard to freeze-outs. Whether some way will be found under the federal securities laws to provide the same degree of protection to minority shareholders with regard to other aspects of corporate life remains to be seen.

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See Robb v. Eastgate Hotel, Inc., 347 Ill. App. 261, 106 N.E.2d 848 (1952): "The majority shareholders do not by the mere reason of their holdings thereby become trustees for the minority stockholder..." Id. at 274, 106 N.E.2d at 854.


101 Such a sentiment is indicated by the accelerating trend toward state court acceptance of the majority shareholder's fiduciary duty to the minority. See text at notes 34-35 supra.

102 One of the most significant examples of the increasing societal concern for the plight of the economic underdog is the great increase in interest in consumer protection in recent years. See, e.g., Knauer, No Minor Imperfection, 49 Neb. L. Rev. 722 (1970); Note, Federal Jurisdiction—Protective Jurisdiction and Adoption as Alternative Techniques for Conferring Jurisdiction on Federal Courts in Consumer Class Actions, 69 Mich. L. Rev. 710 (1971).