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THE REVERSE STOCK SPLIT—THAT OTHER MEANS OF GOING PRIVATE

PAUL H. DYKSTRA*

"Take some more tea," the March Hare said to Alice very earnestly.

"I've had nothing yet," Alice replied in an offended tone, "so I can't take more."

"You mean, you can't take less," said the Hatter; "it's very easy to take more than nothing."

—Lewis Carroll, Alice in Wonderland

During the surging bull market between 1967 and 1972, some 3,000 corporations filed registration statements with the Securities and Exchange Commission offering their stock to the public for the first time. The investing public, beguiled by the prospect of seemingly unlimited growth in the market value of the securities being offered, could scarcely get enough of these so-called "hot issues." Yet that optimism quickly vanished.

Beginning in January 1973, the stock market experienced its steepest decline since the Depression. Shareholders of newly public companies who had purchased their shares at twenty to thirty times earnings or more have seen this price/earnings ratio collapse, sometimes to as low as two or three. The resulting "spread" on shares traded in the over-the-counter market has made sales of the shares possible only at a considerable additional economic sacrifice to the selling shareholder (if, in fact, he can find any market for his shares at all). Yet in spite of this collapse in the market prices of their

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1. Former SEC Commissioner A.A. Sommer, Jr., "Going Private": A Lesson in Corporate Responsibility, BNA SEC. REG. & L. REP. NO. 278, at D-1 (Nov. 20, 1974) [hereinafter cited as Sommer].
2. The "spread" is the difference between the "bid" price (i.e., what a dealer will buy a share for) and the "asked" price (what he will sell it for). It is common for shares to carry, for example, a bid price of $1 and an asked price of $1.50, which means that the dealer is adding a 50 percent markup.
shares, the earnings and the book value per share of the issuing corporations in most cases have been relatively unaffected.3

This rather bizarre amalgam of acutely depressed stock prices (which have only recently experienced a rebound) and continued healthy corporate earnings has led to the phenomenon which may become every bit as popular as going public was five years ago—the “going private” transaction.4 While there is no precise definition of “going private,” companies which do so almost always have as a prime objective the elimination of sufficient shareholders (to a number below 300) so as to terminate their registration under § 12 of the Securities Exchange Act of 1934 and their concomitant obligation under that Act to furnish periodic reports to shareholders and the SEC.5

METHODS OF GOING PRIVATE

Nearly all attempts to go private utilize variations of one or more of a limited number of basic techniques. These include (in probable order of

5. Pursuant to § 12(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78l(g) (1970) [hereinafter referred to in this article as the “1934 Act”], most issuers having an outstanding equity security held of record by 500 or more persons are required to register the security with the Securities and Exchange Commission and thereby become subject to the periodic reporting requirements imposed by §§ 13 and 15(d) of the 1934 Act, 15 U.S.C. §§ 78m, 78o(d) (1970). These periodic reports include the issuer’s annual report on Form 10-K, 17 C.F.R. § 249.310 (1975), quarterly reports on Form 10-Q, 17 C.F.R. § 249.308a (1975), monthly reports (if a reportable event has occurred during the preceding month) on Form 8-K, 17 C.F.R. § 249.308 (1975) and reports of beneficial ownership on Form 3, 17 C.F.R. § 249.103 (1975) and Form 4, 17 C.F.R. § 249.104 (1975) for officers, directors and 10 percent shareholders. In addition, the issuer’s proxy statements must contain the information required by Schedule 14A under Regulation 14A under the 1934 Act, 17 C.F.R. § 240.14a-101 (1975). An issuer may deregister an equity security by filing a certification with the commission that there are fewer than 300 holders of record of the security. 15 U.S.C. §§ 78l(g)(4), 78o(d) (1970); see note 60 infra.

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frequency): (1) A cash tender offer by the issuer, its management or an affiliated entity; (2) a merger or consolidation of the issuer with, or the sale of its assets to, another corporation controlled by management of the issuer; (3) an exchange offer (almost always involving a debt security) by the issuer, its management or an affiliated entity; and (4) a reverse stock split.6

Much has been written lately about the first three methods listed above—their advantages and disadvantages to the corporation, its principal shareholders and its minority shareholders.7 There has been a surprising lack of comment and only one reported judicial decision, however, on that "other" means of going private—the reverse stock split, which in many instances may be the issuer's most certain and economical method of achieving its objective.8

EXPLANATION OF THE REVERSE STOCK SPLIT

As the term implies, the reverse stock split is the conventional stock split in reverse—instead of a company amending its charter so as to have more shares authorized and outstanding, the charter is amended so as to reduce dramatically the authorized and outstanding shares. A more direct and descriptive term might be "stock consolidation."

As an illustration, let us assume that a corporation's charter authorizes the issuance of 1,000,000 shares of common stock, with a par value of $.01 per share, all of which are currently outstanding. Further assume that these shares are held by 750 shareholders, of whom only 15 hold 1,000 shares or more. The corporation then amends its charter so as to authorize the issuance of only 1,000 shares of common stock, with a par value of $10.00 per share. As a result, each share existing before the amendment is reclassified into 1/1,000 of a share following the amendment; every shareholder who held fewer than 1,000 old shares now will hold less than one full share, or a fractional share. Finally, in lieu of issuing fractional shares to these holders, the corporation, as it is permitted to do under most state statutes,9 pays them cash for their fractional holdings. The result of the

6. See Kirshberg & Ellis, supra note 4, at 6.
7. See note 4 supra.
8. See Lawson, Reverse Stock Splits: The Fiduciary's Obligations Under State Law, 63 Cal. L. Rev. 1226 (1975) [hereinafter cited as Lawson]. The following commentators make passing references to the reverse stock split: Sommer, supra note 1, at D-3; Going Private, supra note 4, at 911, 919; Kessler, supra note 4, at 708 n.32, 709 n.37; O'Neal, supra note 4, at § 5.32; Kirshberg & Ellis, supra note 4, at 6, 9; Borden, supra note 4, at 999-1000; Brudney & Chirelstein, supra note 4, at 1021; Establishing Federal Standards, supra note 4, at 643. The only reported decision adjudicating the propriety of a reverse stock split is Teschner v. Chicago Title & Trust Co., 59 Ill. 2d 452, 322 N.E.2d 54 (1974), appeal dismissed, 422 U.S. 1002 (1975); see text following note 67 infra.
amendment, then, is a reduction of the number of the corporation’s shareholders from 750 to 15—it has gone private.

ADVANTAGES AND DISADVANTAGES OF GOING PRIVATE

For smaller publicly-held companies with only a few hundred thousand shares outstanding and with shares trading at $1 or less, the annual costs of complying with SEC reporting requirements can be very significant. The fees of law firms and accounting firms which must be retained to assist in the assembling of information for and the drafting and review of these reports often aggregate $25,000 per year and, up for these services alone.10 This means that if the corporation has, for example, 500,000 shares of stock outstanding which trade at a price of $1 per share, its annual legal and accounting fees relating to SEC compliance would equal five percent of the market price per share. Substantial, if less measurable, additional costs inure to the corporation in the form of salaries paid to internal personnel who have responsibility for SEC compliance. Moreover, the greater the number of shareholders, particularly those with small holdings, the higher are the corporation’s postage, printing, and transfer agent costs. As a result of these factors, the annual cost to small publicly-held corporations of complying with SEC requirements can be a very high proportion of the trading price of their outstanding stock.

Going private can provide significant internal benefits to a corporation. Instead of leaving its key employees with stock options which have gone “underwater” because of a precipitous drop in the public market price of its stock, corporations which go private can peg the option price to the stock’s book value, which often exhibits a steady advance from year to year, irrespective of market trends and prices. Likewise, a corporation desiring to issue its stock in a merger or acquisition will find going private to its advantage, in that it need not be hindered in the transaction by what it regards as an unreasonably low public market price for its shares but instead can agree upon a more realistic valuation through private negotiation.11

Going private in some cases can be justified as simply a good corporate investment, particularly when it results in a positive effect on earnings per


11. See Going Private, supra note 4, at 908-09. In addition, companies listed on a national securities exchange which go private may save several thousand dollars in annual listing fees upon delisting. Id. at 904 n.7.
share (by reducing the number of shares outstanding) or when it causes an increase in the book value per share (when the repurchase is effected at a price less than existing book value). While it is true that there will no longer be a meaningful public market for the shares following the going private transaction, the corporation can still benefit from an upward revaluation of its own shares by negotiating acquisitions or issuing stock options on more attractive terms, as described above.12

For economic reasons alone, then, "going private" makes sense for many companies. Ancillary benefits include a reduction in the possibility of litigation based on allegedly misleading or incomplete SEC reports and freedom from subsequent takeover attempts by outsiders.13 Another, less defensible, advantage is the elimination of the quarrelsome or litigious shareholder.

The going private transaction often benefits the shareholders themselves, particularly those owning shares of issuers whose stock has a small "float" and thus a relatively illiquid trading market. These holders normally may sell only at a disproportionately large "spread" and thus incur, in effect, a penalty for their sale.14 The going private transaction offers these shareholders the opportunity to realize some cash (albeit substantially less than they originally paid out) for their shares at a time when no other reasonable selling opportunity is available.

The long-term economic benefits which a corporation hopes to derive from going private are not without their short-term costs. No matter which method is selected, the purchase price of reacquiring shares held by the public is substantial, often amounting to hundreds of thousands of dollars even for very small publicly-held issuers.15 Legal and accounting fees incurred in drafting the going private materials to be furnished to shareholders are often many times larger than the annual legal and accounting fees incurred in complying with SEC requirements. Printing and postage costs are likewise sizeable. In most going private transactions, substantial amounts must be paid to the investment banking firm serving as dealer-manager, to the proxy solicitation firm assisting in obtaining a favorable shareholder response, to the bank serving as depositary for the shares in the case of tender or exchange offers, and to the independent appraisal firms providing the corporation with an estimate of the stock's fair value. Additional fees and expenses may be incurred in complying with the requirements of state Blue Sky laws. Advertisements in financial publica-

12. See id. at 906-09.
13. See generally LEE & RILANDER, supra note 4, at 2-3.
14. See note 2 supra.
15. See Going Private, supra note 4, at 907-08.
tions, sometimes essential to the success of a tender offer, for example, may be costly. Finally, the mailing to shareholders of going private materials these days is often much like issuing an invitation to meet in court. The corporation should not be surprised if a lawsuit, or at least the threat of one, is forthcoming from a disgruntled shareholder or opportunistic counsel. 16

The disadvantages of a going private transaction to a minority shareholder can be substantial. Whether the transaction is structured so that his participation is outwardly "voluntary" (e.g., a tender offer) or "mandatory" (e.g., a merger), the effect of the transaction upon the small shareholder is essentially the same—inherently coercive. If the shareholder accepts a tender offer, for instance, under present conditions he must usually do so at a price much less than he paid for his shares. If he rejects the offer, he is faced with the real possibility that there will be no meaningful trading market for his shares after the completion of the tender offer. 17 He can hope only that the corporation will follow the tender offer with a traditional "mop-up" technique (e.g., a merger or a reverse stock split) to acquire the remaining minority shares, possibly at a price less than the tender offer price. 18 In the case of a merger, while in most states he may exercise his dissenter's right of appraisal to challenge the price per share offered to him by the corporation, 19 it is usually uneconomical for the holder of only a few hundred shares to do so. 20

Thus, as a practical matter, when a corporation goes private, its minority shareholders are being forcibly divested of their shares for a price which may be only a fraction of what they paid for them. Consequently, they may realize unfavorable tax consequences at a time not of their own


17. See Sommer, supra note 1, at D-3. Former Commissioner Sommer colorfully suggests that a shareholder in this situation is confronted by "a market reduced to glacial activity and the liquidity of the Mojave Desert."

18. See generally Going Private, supra note 4, at 910-11.


20. Referring to this right of appraisal, former Commissioner Sommer observes: "Anyone who has been through one of these so-called 'appraisal proceedings' knows their difficulties. First, they take forever, and during that time typically the dissatisfied shareholder is locked in with an asset he can't sell and he receives no dividends. Furthermore, these actions do not take that form most dreaded by management, the class action; each shareholder must assert his own claim." Sommer, supra note 1, at D-3. See also Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1297 n.4 (2d Cir. 1976) (concurring opinion). See generally Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 HARV. L. REV. 1189, 1201 (1964).
choosing, or they may have to release stock certificates pledged for a loan when it is disadvantageous for them to do so. The shareholders who are taken out are also deprived of the protections against insider trading and of the additional disclosure required of corporations registered under § 12 of the 1934 Act. Finally, such shareholders are deprived of the opportunity to participate in a business that management thinks is on the upswing, since this is presumably why the corporation has elected to go private in the first place.

**SPECIAL ADVANTAGES OF THE REVERSE STOCK SPLIT**

All going private transactions, then, present certain distinct disadvantages to corporations and their shareholders. If management decides nonetheless to proceed with the going private transaction, it would be well advised to think of the reverse stock split first rather than after the other more popular methods have been rejected. The reason is that, on balance, the reverse stock split is the most economical and direct method of achieving private status for many corporations.

One of the principal advantages of the reverse split over other methods of going private is the certainty and finality lacking in the tender offer or the exchange offer. Assuming that it has the requisite number of votes to assure approval of the charter amendment, management, by fixing the ratio of new shares to old shares at the inception of the reverse split, knows in advance what the number of shareholders, the number of shares outstanding and the proportion of ownership will be after the charter amendment. Management can thus be certain that the corporation will have fewer than 300 stockholders and accordingly will no longer have to comply with SEC reporting requirements. It knows in advance that, unlike a tender offer situation, it will not have to resurrect the transaction at a later time or follow it up with another "mop-up" transaction to eliminate a lingering minority. Likewise, it can gauge with far greater accuracy what the transaction will cost.

A second advantage to the use of a reverse split is that it is generally a less expensive means of going private than the other methods. Virtually the only document employed is a proxy statement. This contrasts with a

21. See note 5 supra and Going Private, supra note 4, at 907.
22. See note 5 supra.
23. In the event that management already has enough votes to pass the amendment so that a solicitation of the votes of the minority shareholders is unnecessary (see note 32 infra), it must still furnish such shareholders with an information statement pursuant to Regulation C under § 14(c) of the 1934 Act, 17 C.F.R. § 240.14c-2 (1975). The disclosure required to be included in the information statement by Schedule C to Regulation 14C, 17 C.F.R. § 14c-4 (1975) is similar to that required in the proxy statement by Schedule A to Regulation 14A, 17 C.F.R. § 14a-5 (1975). See note 5 supra and text following note 51 infra. This article will employ the term "proxy statement" so as to include the term "information statement" where the context requires.
merger, which involves the furnishing to each shareholder of a proxy statement, a lengthy SEC prospectus containing detailed information concerning each of the parties to the merger, and a sometimes prolix merger agreement. Legal, accounting and printing costs incurred in drafting these documents are sizeable, and delays in awaiting their review by the SEC may be lengthy. Further, unlike a merger, dissenters’ statutory rights of appraisal generally do not apply to a reverse stock split. While the price paid per fractional share is still subject to challenge in an ordinary lawsuit brought by a disappointed shareholder, it is unlikely that a minority shareholder would be willing to incur the expense of such suit.

The reverse split is usually cheaper than a tender or exchange offer for the reason that the entity making the offer generally must offer a price per share substantially in excess of the current market price in order to enhance the prospects of success. Such a sizeable “sweetener” is seldom necessary to the success of a reverse split because it is essentially an involuntary transaction with respect to the minority holders. Further, a tender offer or exchange offer is sometimes preceded by the corporation’s repurchase of its shares in open market transactions, thereby driving up the market price of the stock and increasing the costs of the offer. These preliminary purchases are absent in a reverse split.

The reverse split does not require the corporation, in most cases, to pay the sizeable fees of a dealer-manager, a proxy soliciting firm, or a depositary, all of which are usually essential to the success of a tender offer. Newspaper advertisements are obviously not necessary. Because only a charter amendment is involved, unlike in a tender offer, state Blue Sky laws generally do not require that the reverse split transaction be effected through a registered broker-dealer.

At least for the time being, the reverse split offers a third advantage because it probably gives the corporation greater insulation from litigation

24. Securities to be offered to shareholders in a proposed merger or consolidation are generally required to be registered under the Securities Act of 1933 by the terms of Rule 145, 17 C.F.R. § 230.145 (1975). Accordingly, the issuer must prepare and file with the SEC a registration statement, usually on Form S-14, 2 CCH FED. SEC. L. REP. ¶ 7271, containing detailed information concerning the transaction. Rule 145(a)(1), 17 C.F.R. § 230.145(a)(1) (1975) specifically excludes a reverse stock split from such requirements.

25. Because a registration statement is involved, the materials cannot be mailed in final form to shareholders until the registration statement is declared effective by the SEC. This process, which may involve the filing of a series of amendments to the registration statement to conform to “comments” of the SEC staff, can take weeks or even several months. In a situation in which only a proxy statement is involved, such as a reverse split, the issuer only is required to file preliminary copies of the proxy materials with the SEC at least 10 days prior to mailing out definitive copies thereof to the shareholders. Rule 14a-6 to Regulation A under the 1934 Act, 17 C.F.R. § 14a-6 (1975). However, see text following note 43 infra.

26. The requirement imposed by Blue Sky laws of many states that certain transactions be effected through a broker-dealer registered in those states is often an important factor in deciding to retain an investment banking firm as a dealer-manager in a tender or exchange offer. But see text preceding note 66 infra.
than does a merger or a tender or exchange offer. Such as it is, all of the precedent for a reverse split is favorable—the only reported case adjudicating its propriety upheld the transaction for the reason that the corporation complied with statutory procedures. The case law with respect to tender offers, on the other hand, is developing rapidly and uncertainly. It is difficult, for example, to be sure what does and what does not constitute a tender offer. It may be considerably more demanding upon counsel to draft tender or exchange offer materials so as not to omit or misstate a material fact with respect to the offeror’s future plans for the issuer following the offer, its financing of the offer, the fairness of the price, significant developments, and the like. Mergers and tender offers have often been struck down on the basis of inherent unfairness or lack of legitimate business purpose. The very fact that all small shareholders are removed as a result of a reverse split makes future litigation less likely than in a tender offer, for example, where non-tendering shareholders sometimes linger on and then sue the corporation. Finally, the fact that the charter amendment has been approved by the requisite statutory vote might in some instances be persuasive to a court evaluating the propriety of the reverse split.

27. Teschner v. Chicago Title & Trust Co., 59 Ill. 2d 452, 322 N.E.2d 54 (1974), appeal dismissed, 422 U.S. 1002 (1975); but see note 30 infra and text at notes 87 and 88 infra.

28. See generally Einhorn, Takeover Developments, 6 REV. OF SEC. REG. 815, 815-16 (1973).


A complaint is cognizable under Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975), when it alleges that the majority breached its fiduciary duty to the minority by effecting a short-form merger “without any justifiable business purpose”. Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1291 (2d Cir.), petition for cert. filed, 44 U.S.L.W. 3743 (U.S. May 14, 1976). In Green, the court of appeals managed to find a cause of action under Rule 10b-5 even while acknowledging that the majority had fully complied with state law and had not misrepresented or failed to disclose a material fact with respect to the short-form merger. The sweeping language of the majority opinion, unless later qualified or overruled, seems applicable to reverse stock splits and thus may make them similarly vulnerable to Rule 10b-5 actions:

When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders’ interest for the sole purpose of feeding the pocketbooks of the controlling shareholders, such conduct goes beyond mere negligent mismanagement and is properly cognizable as “an act, practice, or course of business which operates or would operate as a fraud*. * *.” The majority has abused its equitable powers by exercising them for the “aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuits.” Pepper v. Litton, [308 U.S. at 311] . . . See also Drochman v. Harvey, 453 F.2d 722, 736 (2d Cir. 1972) (en banc).

533 F.2d at 1290.


32. However, shareholder ratification is meaningful only when a substantial majority of disinterested shareholders approves the transaction; the inadequacy of ratification by those in control has been discussed elsewhere at length. See Brudney & Chirelstein, supra note 4, at 299-300; Borden, Going Private, 8 REV. OF SEC. REG. 833, 839-40 (1975).
The reverse split, together with the merger, have one further important practical advantage over a tender or exchange offer. Many corporations have several hundred or even several thousand shareholders whose whereabouts are unknown but who must still be considered record holders by the corporation. As a result, even if the tender or exchange offer is an enormous success, the corporation cannot represent to the SEC that it has fewer than 300 record holders without first eliminating these unknown holders from its stock lists. Such an elimination cannot be effected without first resolving difficult problems of escheat or reversion. Since almost all unknown shareholders hold small numbers of shares, these holders would automatically be eliminated following a reverse split or merger, and the going private transaction would be complete shortly after filing the proper certification with the SEC.

**SPECIAL DISADVANTAGES OF THE REVERSE SPLIT**

The reverse split is not without significant drawbacks, which in some instances will foreclose its use altogether. One of the principal disadvantages is that a reverse split requires an amendment of the corporate charter. Obviously it will not work unless the corporation can obtain the number of votes necessary to amend the charter. While management of a publicly-held corporation seldom has difficulty in procuring the requisite shareholder vote for a proposal which it supports, a reverse split is likely to engender more opposition than other proposals because it strikes at the very heart of share

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33. Even though the whereabouts of such shareholders are unknown, the corporation itself still carries them as the holders of record on its stock lists and indicates the shares so held as outstanding on its financial statements and reports. Rule 12g5-1 under the 1934 Act, 17 C.F.R. § 240.12g5-1 (1975), which defines the term "held of record," makes no exception for unreachable holders.

34. Absent a successful going private transaction, there are probably only two ways to remove unknown shareholders from the corporation's stock lists. One is for the corporation to take steps to have the shares escheat to the state (see, e.g., Del. Code Ann. tit. 12, § 1198 (1974)). The gist of this procedure is that the passage of time without action of some sort by the record holder raises the presumption that the stock has been abandoned, and then title to the stock may be transferred to the state by judicial or administrative proceedings. The state which is entitled to this stock is governed by the law of escheat of the state listed as the last known address of the shareholder on the company's records; in the absence of such a law, the law of escheat of the state of incorporation normally governs. See Texas v. New Jersey, 379 U.S. 674 (1965). Accordingly, this procedure requires a survey of the law of escheat for every state in which the corporation has an unknown shareholder and can turn into an administrative nightmare. See Pennsylvania v. New York, 407 U.S. 206 (1972), and Note, Escheat of Intangibles: The Conflicts Problems Remain, 34 U. Pitt. L. Rev. 671 (1973). As a result, the employment of escheat as a method for removing large numbers of unknown holders of record is almost hopelessly unwieldy.

Another such means of removal is for the corporation to amend its charter or by-laws so as to have the shares of unknown shareholders revert to the corporation. See Note, Disposition of Unclaimed Dividends and Shares-Distributions from Interstate Business Associations, 17 Vand. L. Rev. 1354 (1964). However, courts which have considered this procedure have almost universally condemned it. See, e.g., State v. Jefferson Lake Sulphur Co., 36 N.J. 577, 178 A.2d 329 (1962) and Maguire v. Hibernia Sav. & Loan Soc'y, 23 Cal. 2d 719, 146 P.2d 673 (1944).

35. See note 4 supra and notes 59 and 60 infra.
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ownership. It is a request to minority shareholders to vote in favor of terminating their participation in the enterprise.

Moreover, if the corporation has a class of preferred stock outstanding, a strong case can be made that the holders of the preferred stock are entitled to vote separately as a class on the proposed amendment. Most state statutes require such a separate class vote if the rights or preferences of the holders of that class would be adversely affected by the proposed amendment. Since the result of a reverse split may be that the corporation distributes large amounts of cash to the holders of its common stock in exchange for their fractional shares while the preferred shareholders get nothing, it may be persuasively argued that the preferences of the preferred stock are indeed being adversely affected so that a class vote is required. In that event, it may be much more difficult for the corporation to obtain the requisite approval of the holders of the preferred stock, particularly if that stock is closely held by persons unaffiliated with management. This situation contrasts sharply, of course, with a tender offer, for which no shareholder vote is required and which may fulfill corporate objectives even if all shareholders do not tender.

Perhaps the most significant drawback to the reverse split, at least for the time being, is that, since a charter amendment is involved, proxy materials must be prepared and, in the case of companies whose securities are registered under the 1934 Act, filed with the SEC. Normally it is a perfunctory matter for a corporation to file its proxy materials with the SEC, which typically renders advisory comments as to the information which the materials should contain within ten days after filing. These “suggestions” are generally complied with by the issuer and the proxy materials are then mailed out to security holders a short time later.

On February 6, 1975, the SEC issued for comment proposed Rules 13e-3A and 13e-3B under the 1934 Act—the controversial “going private rules.” Rule 13e-3A, if adopted, would require an extensive disclosures on the part of an issuer or affiliated persons seeking to go private, including audited financial statements for the issuer’s two most recent fiscal years, unaudited “stub” financial statements, pro forma financial statements showing the effect of the proposed transaction on the issuer, a discussion of the purpose of the transaction and any further actions planned by the issuer.

38. If the preferred stock is publicly held, of course, it, too, should be subject to the reverse split. See text preceding note 5 supra and note 58 infra.
39. See note 25 supra.
management, a general description of federal tax consequences to the issuer and its shareholders, and an appraisal from two qualified independent persons as to the adequacy of the consideration to be paid to the shareholders, with the proviso that the consideration may be no lower than that which is jointly recommended by the two appraisers. It is, of course, true that counsel for any issuer which is planning a reverse split would doubtless insist that much of the foregoing information be included in the issuer's proxy statement on the ground that it is material to the shareholder's ability to cast his vote intelligently. Counsel might well conclude, however, that some of this disclosure, such as the extensive financial data or the recommendations of the two independent appraisers, is not a condition precedent to an informed decision.

As it happens, what counsel may think should be included in the going private materials, the fact that the going private rules are merely proposed rules on which no hearings have been held, and the fact that the comments on these proposals have been so critical that it is unlikely that they will be adopted in their present form appear to be of only moderate concern to the staff of the SEC. In possible violation of the Administrative Procedure Act, some members of the staff on occasion have been "enforcing" proposed Rule 13e-3A as if it were currently in effect. They will not "clear" a proxy statement relating to a planned reverse split unless all data called for by proposed Rule 13e-3A are furnished.

The upshot of all this is that the reverse split, which should be a relatively simple, direct and economical procedure for an issuer, in some instances cannot be effected without incurring the sizeable costs resulting from the drafting and printing of what amounts to a very substantial disclosure document and the substantial fees charged by the independent appraisal firms. The alternatives for the issuer who is unwilling to furnish all of the information called for by the proposed rule are unhappy ones. The issuer can either ignore the SEC "suggestions" for more disclosure, thereby running the risk that the SEC will seek to enjoin the solicitation of proxies or the meeting at which the reverse split is to be voted upon, or it can avoid

41. See generally Haft, supra note 29.
42. See BNA SEC. REG. & L. Rep. No. 318, at A-1 (Sept. 10, 1975). Many of such comment letters, such as that of the Committee on Federal Regulation of Securities of the American Bar Association, have questioned not only the wisdom of the proposed rules but whether the SEC has the statutory authority to impose substantive requirements of fairness. Id. at A-2.
43. 5 U.S.C. § 553(c)(1970); see, e.g., Buckeye Power, Inc. v. EPA, 481 F.2d 162 (6th Cir. 1973).
45. See the 1934 Act, 15 U.S.C. § 78aa (1970). If the SEC did attempt to enjoin the solicitation of proxies or the meeting (or to void it afterwards), it is most unlikely that it would rely upon the terms of proposed Rule 13e-3A. Instead it would probably assert a violation of existing Rule 14a-9. 17 C.F.R. §
such a confrontation with the SEC by abandoning current plans for the reverse split altogether which appears to be the much wiser course. Such issuers instead should consider a tender offer which, although subject to the same disclosure requirements as a reverse split, involves no materials required to be filed with the SEC, which therefore cannot "enforce" its proposed rule.

**MECHANICS OF THE REVERSE SPLIT**

As already explained, the essence of a reverse stock split is the amendment of the corporate charter so as to consolidate the number of shares which are authorized and outstanding. The chief goal of management generally is to reduce the number of its record holders to below 300 so that the corporation can terminate its obligation to comply with SEC reporting requirements. An ancillary objective, which might be best left unstated, may be to eliminate certain especially obstreperous shareholders. Accordingly, management must fix the ratio of old shares to new shares necessary to achieve its goals. For the sake of simplicity, the denominator of this ratio is typically divisible by 100 or 1,000.

Management also must establish the price to be paid by the corporation per fractional share. Prudence in many instances would suggest that this amount be at least the higher of the corporation’s book value per share and the most recent asked price of the shares, so as to help establish management’s good faith in the event of subsequent litigation attacking the price to be paid. In any event, the price to be paid should be on the generous side. Thereupon, as in any charter amendment, the board of directors must adopt resolutions setting forth the proposed amendments, declaring their advisability, and either calling a special meeting of shareholders or directing that the proposed amendments be considered at the next annual meeting.

240.14a-9 (1975), its "elastic clause," which prohibits the use of a proxy statement which "is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading . . . ." Even in the absence of an injunction, any issuer which intentionally fails to comply with SEC suggestions may find its future filings beset by lengthy delays and uncommon scrutiny.

46. See text accompanying note 9 supra.
47. See text preceding note 5 supra.
48. While it is possible for this ratio to be fixed so that only one shareholder remains after the split, management (particularly if it holds only a bare majority of the outstanding shares) thereby runs the risk that a court will overturn the transaction as a sham since the majority may have greater difficulty in establishing a legitimate business purpose. See text preceding note 54 infra and text following note 88 infra.
49. For convenience, the par value per share is normally increased by the same proportion as that by which the number of shares is reduced. See text at note 65 infra.
50. A Delaware corporation may amend its certificate of incorporation "[t]o increase or decrease its authorized capital stock or to reclassify the same, by changing the number, par value [etc.] . . . of the shares . . . ." Del. Code Ann. tit. 8, § 242(a)(3) (1974). It may "purchase, redeem, receive, take or
Management, together with its counsel, should allow several weeks for the drafting of the proxy materials, which include the notice of meeting, proxy statement, proxy, and the text of the proposed amendments. Counsel should consult with the SEC branch chief of the issuer in advance to ascertain whether that particular branch is applying the proposed going private rules.\textsuperscript{51} If so and if management decides to proceed with the reverse split nonetheless, the drafting of the proxy statement at least may be undertaken with a fairly precise idea of what information must be included. In addition, two appraisal firms should be retained at once. If the SEC branch does not apply the proposed rules (or they have been rescinded), counsel may conveniently use these rules as a guide for disclosure, so as to include in the proxy statement as much of such information as he deems material.\textsuperscript{52}

Counsel should pay special attention to Item 13 of Schedule A to Regulation 14A under the 1934 Act.\textsuperscript{53} This item, which must be answered if an outstanding class of securities is to be modified, requires a description of the outstanding securities and the effect of the proposed amendment thereon, a statement of the reasons for the proposed amendment, and "such other information as may be appropriate in the particular case to disclose adequately the nature and effect of the proposed action." While the extent of the "other information" is ultimately a matter for the issuer and its counsel to decide upon, in almost all cases it would include disclosure as to the number of record holders which would exist after the adoption of the proposed charter amendment, a statement that the issuer would no longer be registered under the 1934 Act and accordingly would cease filing the periodic reports required thereunder, a description of the number of shares and the proportion of ownership to be held by management and other

otherwise acquire . . . . its own shares . . . . Id. § 160(a). A Delaware corporation "may, but shall not be required to, issue fractions of a share. If it does not issue fractions of a share, it shall . . . . pay in cash the fair value of fractions of a share as of the time when those entitled to receive such fractions are determined . . . ." Id. § 155.

An Illinois corporation may amend its articles of incorporation so as to "[i]ncrease or decrease the aggregate number of shares, or shares of any class, which the corporation has authority to issue" (ILL. REV. STAT. ch. 32, § 157.52-5 (1975)); "[i]ncrease or decrease the par value of the authorized shares of any class having a par value . . . ." (id. § 157.52-6); and "[e]xchange, classify, reclassify, or cancel all or any part of its shares, whether issued or unissued." (Id. § 157.52-7). Further, "[a] corporation shall have power to purchase, take, receive, or otherwise acquire . . . . its own shares . . . . [and it] may purchase or otherwise acquire its own shares for the purpose of . . . . [e]liminating fractional shares." (Id. § 157.6(a)). In addition, "[a] corporation may, but shall not be obliged to, issue a certificate for a fractional share, and, by action of its board of directors, may in lieu thereof, pay cash equal to the value of said fractional share . . . ." (Id. § 157.22).

51. See text following note 43 infra.

52. Tender offer or going private merger materials involving other corporations, which generally may be obtained without charge from investment banking firms or financial printers, are similarly helpful reference tools.

53. 3 CCH FED. SEC. L. REP. ¶ 26,871, at 20,136.
affiliated persons, a discussion of the method of arriving at the price to be paid per fractional share (including information as to recent market prices of the shares and as to the current book value per share), and a statement to the effect that there would likely be no meaningful trading market in the issuer’s securities following the adoption of the amendment. Management should also discuss what changes, if any, it intends to make in the company’s operations following the adoption of the amendment.

Perhaps most important, the proxy statement should disclose the reason for the proposed reverse split—the corporation’s avowed business purpose. Where the purpose, at least in part, is to effect corporate savings, the estimated amount of these savings, together with the costs of the proposed transaction, should be quantified to the extent possible. Likewise, pursuant to Item 15 of Schedule A, the corporation should include in its proxy statement the financial statements required by Form 10 under the 1934 Act, although the SEC staff may permit the omission of certain of these statements if they “are not necessary for the exercise of prudent judgment in regard to any matter to be acted upon.” In this connection, a pre-filing conference with the branch chief can be fruitful.

Following review and comment by the SEC staff, the proxy materials as revised are mailed to the shareholders, the meeting is held, and the proposed amendment voted upon. If adopted, the amendment is filed with the secretary of state in the state of incorporation and becomes effective upon such filing. Management should then furnish a letter to each record holder of fractional shares requesting a surrender of his share certificate for the specified amount of cash and a letter to each record holder of full shares offering to exchange a new certificate for his old one. Irrespective of when the holders of fractional shares surrender their certificates, they cease to be

54. Cf. Kessler, supra note 4, at 709; see text following note 88 infra. For an enumeration of possible additional legitimate business purposes, see e.g., Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., Civil No. 10409-1975 (N.Y. Sup. Ct., Feb. 11, 1976); Merrit v. Libby, McNeill & Libby, 533 F.2d 1310 (2d Cir. 1976); and text following note 10 supra.

55. 3 CCH FED. SEC. L. REP. ¶ 26,871, at 20,139.


57. Although not essential, it is common to include the full text of the proposed amendments as an appendix to the proxy statement.

58. DEL. CODE ANN. tit. 8, §§ 103, 242(c)(3) (1974); ILL. REV. STAT. ch. 32, §§ 157.56, 157.57 (1975). In Illinois the articles of amendment must also be filed with the recorder of deeds of the county in which the registered office of the corporation is located. ILL. REV. STAT. ch. 32, § 157.56 (1975). Filings must also be made in most states in which the corporation is qualified as a foreign corporation. In Delaware, a simple majority of those entitled to vote thereon is required for the adoption of the amendment. DEL. CODE ANN. tit. 8, § 242(c)(1) (1974). In Illinois, it must be approved by a two-thirds majority. ILL. REV. STAT. ch. 32, § 157.53(c) (1975). For requirements as to a separate class vote, see text following note 36 supra. In some instances, it may be advisable to structure the transaction so that the preferred stock is subject to the reverse split as well.
record holders upon the filing of the amendment with the secretary of state.\textsuperscript{59} As a result, the issuer may file immediately thereafter its certification to the SEC that it has fewer than 300 record shareholders. Pursuant to § 12(g)(4) of the 1934 Act, the corporation’s registration and its concomitant obligation to file reports under the 1934 Act normally terminate ninety days thereafter.\textsuperscript{60}

POTENTIAL PITFALLS

If the corporation has outstanding a class of securities convertible into the shares which are to be consolidated or options or warrants for these shares, counsel should be certain that the terms of conversion or exercise are adjusted to reflect the reverse split. Furthermore, in the event that securities of this kind are outstanding, the corporation is deemed by the SEC to be engaged in a continuing distribution of the underlying common stock and, pursuant to Rule 10b-6 under the 1934 Act, may not effect a “purchase” of its common stock without an exemption.\textsuperscript{61} The payment of cash for fractional shares following a reverse split is a “purchase” within the prohibitions of Rule 10b-6.\textsuperscript{62} Accordingly, prior to paying cash for its fractional shares, an issuer with outstanding convertible securities, options or warrants should obtain an exemption from Rule 10b-6. This exemption should be readily forthcoming, in view of the fact that revised proposed Rule 13e-2 would exempt from the definition of “purchase” the payment of cash for “any fractional interest in a security.”\textsuperscript{63}

\textsuperscript{59} Provided, of course, that the amendment or the resolutions of the board are drafted so as to provide specifically that all persons entitled to less than a full share shall cease to be shareholders of the corporation upon the effectiveness of the amendment. For a discussion of the accounting treatment of the reverse split and the filing of reports reflecting a reduction in capital, see note 65 infra and the preceding text.

\textsuperscript{60} See note 5 supra. The SEC staff requires the corporation to continue to file reports during this ninety-day waiting period, but normally does not require the filing of reports pertaining to this period after its expiration. If the issuer has filed a registration statement under the Securities Act of 1933 containing an undertaking to file the periodic reports required by the 1934 Act, it must also file a certification of deregistration pursuant to Rule 15d-6, 17 C.F.R. § 240.15d-6 (1976). This certification may be filed only if the issuer has fewer than 300 holders of record of the security to be deregistered at the beginning of that fiscal year and becomes effective immediately upon filing. Effective August 2, 1976, the SEC adopted Form 12g/15d-6, which is to be used for deregistration under either § 12(g)(4) or § 15(d)(6). SEC Securities Exchange Act Release No. 12551 (June 17, 1976) [Current] CCH FED. SEC. L. REP. ¶ 80,603.

\textsuperscript{61} Paragraph (b) of Rule 10b-6, 17 C.F.R. § 240.10b-6(b) (1975), provides that “[t]he distribution of a security (1) which is immediately exchangeable for or convertible into another security, or (2) which entitles the holder thereof immediately to acquire another security, shall be deemed to include a distribution of such other security within the meaning of this section.” An exemption from the prohibitions of Rule 10b-6 may be requested by the issuer pursuant to paragraph (f) thereunder. 17 C.F.R. § 240.10b-6(f) (1975).


REVERSE STOCK Splits

The payment of cash for fractional shares is probably a "purchase" under state law as well. Most state statutes provide that a corporation may not purchase its own shares at a time when its capital is impaired (or would be impaired as a consequence of the purchase). As a result of the reverse split, the corporation's stated capital is reduced by an amount equal to the number of "old" shares being repurchased multiplied by the par value thereof, and its earned surplus (i.e., its retained earnings) is reduced by the remaining amount of cash which it must pay out for the fractional shares. This latter amount may not exceed the earned surplus.

Finally, counsel should carefully review the securities laws of the states in which the corporation has shareholders, particularly the provisions relating to the registration of broker-dealers, to be certain that the corporation is not deemed to be a broker-dealer (and thus required to register as such) by virtue of purchasing its own fractional shares. It should be noted that at least one state, Wisconsin, has adopted its own going private rules which specifically apply to a reverse split.

Teschner v. Chicago Title & Trust Co.

It is perhaps surprising that the reverse stock split has resulted in only one reported judicial decision, Teschner v. Chicago Title & Trust Co. Since the Supreme Court of Illinois ruled in that case that a reverse stock
split is proper under Illinois law but carefully limited its holding to the specific facts presented, it is important reading for counsel to companies which are contemplating a reverse split.

In August 1969, Lincoln National Corporation made an exchange offer to the shareholders of Chicago Title and Trust Company, an Illinois corporation, whereby Lincoln offered one share of its preferred stock for each share of Chicago Title common stock. This exchange offer enjoyed an overwhelming acceptance—a total of 2,225,244 shares of common stock of Chicago Title (99.3 percent of those outstanding) were tendered to Lincoln, thereby leaving only about 95 shareholders, holding a total of 8,077 shares of Chicago Title, who had not tendered.68 By most yardsticks, then, Chicago Title had already gone private. Following the exchange offer, its shares were delisted from the New York Stock Exchange and it ceased to be a reporting company under the 1934 Act. After this delisting, a few shares of Chicago Title common stock were traded in a very limited over-the-counter market at prices ranging from $40 to $45 per share.69

In December 1970, Lincoln sent the remaining shareholders of Chicago Title a letter offering to purchase their shares at $69.50 per share, which was the approximate current market price of the Lincoln preferred stock issued in the 1969 exchange offer. Fifty of the remaining shareholders, owning 6,187 shares of Chicago Title, accepted this cash offer, thereby leaving Lincoln with 2,231,431 shares (99.9 percent) of Chicago Title and approximately 45 other shareholders with a total of only 1,890 shares.70

In order to simplify its corporate activities and reduce expenses,71 Lincoln decided to employ a reverse split to eliminate the tiny minority. Lincoln opted against causing Chicago Title to be merged into a wholly-owned subsidiary on the ground that this method would be more expensive and time-consuming than a reverse split, particularly because of problems involving the merger of a trust company.72 It was unable to utilize a short-form merger because this procedure did not become available in Illinois until July 1972.73

68. Id. at 454, 322 N.E.2d at 55.
70. 59 Ill. 2d at 454, 322 N.E.2d at 55.
73. ILL. REV. STAT. ch. 32, § 157.66(a) (1975). This statute permits a subsidiary, at least 99 percent of the outstanding shares of each class of which are owned by the parent, to be merged into the parent by action of the respective boards of directors. No vote of the shareholders is required but each minority shareholder must be notified. Cf. DEL. CODE ANN. tit. 8, § 253 (1974), which permits such a procedure with respect to a 90 percent owned subsidiary. See text preceding note 83 infra.
The proposed amendment adopted by Chicago Title’s directors provided for the reclassification of its 2,233,321 shares of common stock, with a par value of $6 2/3 per share, into 3,722 shares having a par value of $4,000 per share. This was a ratio of one new share for each 600 old shares. The directors further provided that $69.50 (the same amount paid in the tender offer of December 1970) was to be paid for each 1/600 of new share following the adoption of the amendment by the shareholders. Although no independent appraisals were obtained, the price was clearly generous. At a special meeting of the shareholders held in February 1971 to consider the proposed amendment, a total of 2,231,431 votes were cast in its favor and 63 votes were cast against it, all by the plaintiff, Barbara Teschner.

Shortly thereafter, the plaintiff requested the Circuit Court of Cook County to restore her as a shareholder of Chicago Title on the grounds that the action taken at the shareholders’ meeting was invalid as a breach of Lincoln’s fiduciary duty to the minority shareholders of Chicago Title, as a deprivation of her property without due process of law, as a violation of her right to equal protection of the laws, and as an impairment of her contractual rights. The plaintiff’s argument, then, was framed primarily on rather lofty constitutional theories—she alleged, but did not drive home, the point that the majority had violated its fiduciary duty owed to her under the common law by “squeezing out” her interest in the corporation. She did not attack the legitimacy of Chicago Title’s business purpose for the reverse split nor did the Illinois Supreme Court question it. Moreover, Mrs. Teschner did not claim that the price paid for her fractional shares was unfairly low, that Chicago Title had failed to comply with the statutory requirements of the Illinois Business Corporation Act, or that it had acted fraudulently. If she had raised any of these challenges—particularly as to the validity of the business purpose for the transaction or the price paid per share—she would have succeeded at least in shifting the burden to Chicago Title and thereby might have enjoyed a stronger case.

As it was, however, since the court was permitted to presume the sufficiency of Chicago Title’s business purpose and the price which it paid, it had little trouble with the plaintiff’s constitutional arguments. It observed

74. 59 Ill. 2d at 454, 322 N.E.2d at 55.
75. See note 72 supra.
76. 59 Ill. 2d at 454, 322 N.E.2d at 55.
77. Id.
78. "Perhaps plaintiff lost the case by failing to show that defendant Lincoln had a squeeze-out objective, but the court certainly could have inferred that objective from the facts that were established." O’Neal, supra note 4, at 363. See generally Lawson, note 8 supra.
79. 59 Ill. 2d at 459, 322 N.E.2d at 58.
80. Pepper v. Litton, 308 U.S. 295, 306 (1939); see Kessler, supra note 4, at 704-10; Bryan v. Brock & Blevins, 490 F.2d 493 (5th Cir. 1974); cf. Lawson, supra note 8, at 1240.
that the law was well beyond the point where the unanimous consent of a corporation's shareholders was needed to effect fundamental corporate changes.81 Instead, the opinion noted, state legislatures had authorized the making of such changes by majority vote, so as to "provide needed flexibility and to remove what was in effect a power of veto held by a dissenting minority."82 These statutes had been overwhelmingly upheld against constitutional attack. As an illustration, the court referred to the existence of merger statutes which enable the majority to terminate the interests of the minority by paying them the cash value of their stock. It inferred the approval by the Illinois legislature of this policy by citing the recent adoption of the Illinois short-form merger statute, which provides for the elimination of a minority of one percent or less without a shareholder vote.83 While the court acknowledged that some cases and commentators have suggested that a majority may not "freeze out" a minority in the absence of an underlying valid business purpose, it made no analysis of these arguments, for the obvious reason that the plaintiff had not attacked Chicago Title's business purpose.84

Instead, the court upheld the reverse split on the familiar ground that a corporate charter is a contract between the corporation and its shareholders into which must be imputed prevailing statutory provisions. Since Chicago Title had complied with both its charter and the statutory requirements, it had not, in the court's view, impaired the contractual rights of the plaintiff.85

In addition to the fact that Mrs. Teschner did not challenge Chicago Title's business purpose, its good faith, or the price paid per share, the court must have been impressed by the fact that Lincoln owned 99.9 percent of the outstanding shares of Chicago Title. Even if the plaintiff had convinced the court that Illinois law did not specifically authorize the removal of minority shareholders by means of a reverse split and the reverse split had been invalidated, Lincoln had an alternative. At substantial additional expense, Lincoln presumably could have accomplished the same result through a short-form merger, a specific legislative endorsement of minority removal.86 In other words, it is possible that the court viewed the complaint as little more than a strike suit, particularly since the decision was carefully circumscribed by the admonition that "[w]e do not say that under all

81. 59 Ill. 2d at 456, 322 N.E.2d at 56; see also Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1305, 1306 (2d Cir.) (dissenting opinion), petition for cert. filed, 44 U.S.L.W. 3743 (U.S. May 14, 1976).
82. 59 Ill. 2d at 456, 322 N.E.2d at 56.
83. Id. See note 73 supra; but see Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir.), petition for cert. filed, 44 U.S.L.W. 3743 (May 14, 1976).
84. 59 Ill. 2d at 457, 322 N.E.2d at 57.
85. Id. at 458, 322 N.E.2d at 57.
86. See note 73 supra; but cf. Vorenberg, supra note 20, at 1200; Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir.), petition for cert. filed, 44 U.S.L.W. 3743 (U.S. May 14, 1976).
circumstances minority shareholders will be denied relief when the majority has proceeded under the provisions of the Act, but we do not consider that the plaintiff has shown grounds for the relief she seeks."

Teschner, then, is only a limited judicial endorsement of the reverse stock split as applied to a factual situation unusually favorable to the defendants. Even so, the decision has been criticized as "highly questionable" by a leading, if dogmatic, commentator on the removal of minority interests. A more realistic appraisal of Teschner is that it represents a pragmatic judicial acceptance of the principle that minority shareholders do not, and should not, possess what amounts to an inalienable right to remain as participants in the corporate enterprise. It recognizes instead the existence of a corporate right, circumscribed only by considerations of fundamental fairness, to terminate minority participation where appropriate for the efficient functioning of the business. In Teschner that fairness was so evident as to be unquestioned—the price paid to the minority was abundantly adequate, there was no attempt to defraud or to overreach by the majority, and there was a plainly sensible business purpose. Such an analysis lends itself well to any going private transaction.

CONCLUSION

The reverse stock split can be the most direct and economical means for a corporation to return to private status. It should not, however, be viewed as a clever short-cut to be employed when the more popular techniques of going private are foreclosed to the corporation because of equitable or statutory roadblocks. Only if utilized with discretion and formulated with care will it survive judicial scrutiny.

87. 59 Ill. 2d at 457, 322 N.E.2d at 57.
88. O'Neal, supra note 4, at 362; see also Lawson, supra note 8, at 1239.
89. See Sommer, supra note 1, at D-3; Kessler, supra note 4, at 708-09; cases cited note 16 supra.