Geoffrey C. Beaumont et al., Appellants, v. American Can Company, Respondents, Defendants, et al.

Appellate Division of the Supreme Court of the State of New York, First Department.160 A.D.2d 174 (1st Dept. 1990) Decided April 3, 1990

Facts:

This litigation arises out of the April 8, 1982 merger of Associated Madison Companies, Inc. ("Associated") into AC Financial Services, Inc., a wholly-owned subsidiary of American Can Company ("American Can" or "American"). Before the merger, American Can, a New Jersey corporation, was engaged in a variety of enterprises, including the manufacture of cans and different paper products.

On October 27, 1981, American Can and Associated reached an agreement in principle for a proposed merger.

On that date, the companies signed a "Memorandum of Intent" under the terms of which holders of up to 49% of Associated common stock would receive $15 in cash for their shares and the remaining common stockholders would receive $15 worth of American Can shares. In addition, the Memorandum of Intent acknowledged that American Can was considering purchasing Associated shares on the open market or by other means prior to the merger.

American Can subsequently decided to purchase Associated stock from a number of institutional stockholders. It also decided to engage in a tender offer for its own stock to insure that it would have sufficient stock to exchange for Associated shares in the merger. Finally, American Can contemplated that it would permit holders of up to 49% of Associated's common stock to "elect", during the proxy solicitation for the merger, to receive cash or American stock for their shares.

On November 13 and November 20, 1981, American Can's outside counsel wrote to the Securities and Exchange Commission detailing the merger terms and requesting that the SEC declare the proposed pre-merger purchases, self-tender offer, and cash election feature of the merger exempt from SEC Rules 10b-6 and 10b-13.[1] The SEC granted the requested exemptions in two letters dated December 1 and December 24, 1981. Both of the Commission's letters contained a summary of the proposed merger terms and stated that the positions of the Commission were based solely on the facts and representations presented.

In particular, the SEC granted the exemptions on the understanding that holders of Associated common stock would receive $15 in cash or American shares if the merger were approved, and that the institutions from whom American Can would make pre-merger purchases of Associated stock would not receive a price higher than that paid to the rest of the Associated shareholders in the merger.

The SEC advised American Can to complete the pre-merger purchases and the self-tender offer before the mailing of the proxy materials and to disclose in the materials the pre-merger purchases' effect on the availability of cash election rights in the merger.

On January 7, 1982, American Can issued a press release in which it announced that it had agreed to buy 34% of Associated's outstanding common stock from five institutional investors. According to the release, American Can agreed to pay $13 in cash per share, and if the merger were completed at a higher price per share, American Can would pay the institutions an additional amount to match the merger price.

On January 12, 1982, American Can announced the tender offer for its own shares at a price of $33.50 per share. Also on that day, American Can and Associated issued a joint press release stating that the parties had amended the merger terms. Instead of insuring that holders of Associated common stock would receive $15 worth of American Can stock, the revised merger terms adopted a fixed exchange ratio of 0.4545 shares of American Can per share of Associated. This meant that the value of the exchange could be less than $15 depending on the market price of American Can shares at the time of the exchange. On February 23, 1982, the parties signed a final "Agreement and Plan of Merger" which included the revised merger terms. American Can never informed the SEC of the changes.

The Proxy Statement-Prospectus, sent to Associated shareholders on February 25, contained a description of the pre-merger purchases, the self-tender and the merger terms. The materials detailed Associated shareholders' right to elect whether they wanted to have their shares converted into $15 cash per share or into American Can stock at a ratio of 0.4545 per share of Associated.

The proxy statement also disclosed that American Can's previous purchase of Associated stock from institutional holders had substantially reduced the cash available to the remaining Associated stockholders so that only from 8% to 15% of the stockholders would be able to receive cash. The proxy statement did not mention that American Can had sought and obtained exemptions from SEC Rule 10b-6 and no-action positions under Rule 10b-13 on the SEC's understanding that Associated common shareholders would receive $15 worth of American Can stock or $15 in cash for each share of Associated.

Associated's shareholders approved the merger on March 26, 1982. When the merger was consummated on April 8, 1982, approximately 8% of Associated's common shareholders received $15 in cash per share. The remaining Associated common shareholders received American Can stock valued at $12.61 per Associated share.

Plaintiffs commenced this class action on May 28, 1982 on behalf of former Associated shareholders who received American Can stock instead of cash in the merger. They seek to recover the difference between the value of the American Can stock at the time of the exchange and the $15 per share figure contemplated in the original merger negotiations and American Can's correspondence with the SEC.

Procedural History:

Plaintiffs first commenced a class action against the defendants herein in the Southern District of New York. The Federal complaint asserted five causes of action, one of which alleged that defendants violated Business Corporation Law §501.

The District Court subsequently granted defendants summary judgment and dismissed all the causes of action with prejudice, save the State claim. *(Beaumont v. American Can Co.*, 621 F. Supp. 484, *supra.)* After the Second Circuit affirmed the District Court (797 F.2d 79, *supra)*, plaintiffs brought the instant action, asserting two causes of action, i.e., violation of Business Corporation Law § 501 (c) and breach of fiduciary duties by the defendants herein.

In effect, the consolidated and amended supplemental complaint seeks damages of approximately $9,000,000, that is the $2.39 differential between the value of 4.5 million shares of American Can stock which was received at the time of the merger by small private investors and the $15 per share that Associated Madison Companies, Inc. shareholders, whose cash preferences were honored, received.

The individual defendant moved, and American Can Co. cross-moved, to dismiss the consolidated amended and supplemental complaint on the grounds that, *inter alia*, the Business Corporation Law § 501 (c) claim failed to state a cause of action and that the breach of fiduciary duty claim was barred by res judicata. Supreme Court granted the motion.

Discussion:

The Appellate Division disagreed with the decision of the Supreme Court, and found that the plaintiff has, in fact, stated a valid cause of action under Business Corporation Law § 501 (c)

The Appellate Division further held that defendants' contention that the second cause of action, alleging breach of a fiduciary duty, is barred by res judicata is meritless.

While plaintiffs did in fact raise the claim that the merger which is the subject of the within action violated Business Corporation Law § 501 (c) in the Federal court action, the Federal court refused to retain pendent jurisdiction as to any cause of action based upon a non-Federal claim.

Accordingly, the second cause of action herein, a State claim, was not within the Federal court's stated jurisdiction.

As a result, in view of the fact that the Federal court did not consider such claim on the merits, the Appellate Division concluded that res judicata is not applicable, and that the Supreme Court erred in summarily dismissing the second cause of action as barred by res judicata.

Conclusion:

The order appealed from was modified, to the extent of reinstating the first and second causes of action, and otherwise affirmed.

The court therefore confirmed the longstanding principle that the legal status of shares in a corporation cannot be diminished even as a result of a merger.