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## The Sale of Corporate Control

### Cover Page Footnote

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# THE SALE OF CORPORATE CONTROL

DAVID C. BAYNE, S.J.\*

THE quandary in which the New York courts seem to find themselves in the mid-sixties poses an insistent demand for the synthesis of a philosophy of the sale of control—a philosophy so essential to the solution of the *ad hoc* problems faced by corporate law today.<sup>1</sup>

The law was admittedly muddled at the time of *Essex Universal Corp. v. Yates*<sup>2</sup> in 1962. Judge Clark, concurring, was disarmingly forthright, although a bit pessimistic:

But particularly in view of our lack of knowledge of corporate realities and the current standards of business morality, I should . . . hope that if the action again comes before us the record will be generally more instructive on this important issue than it now is. I share all the doubts and questions stated by my brothers in their opinions and perhaps have some additional ones of my own. My concern is lest we may be announcing abstract moral principles which have little validity in daily business practice . . .<sup>3</sup>

This present study, it is feared, has set for its goal those very “abstract moral principles” which concerned Judge Clark.

Judge Friendly, also concurring, certainly knew whereof he spoke: “Here we are forced to decide a question of New York law, of enormous importance to all New York corporations and their stockholders, on which there is hardly enough New York authority for a really informed prediction . . . .”<sup>4</sup> But New York authority did not become any more informative as the days passed. Nor was the proof of Judge Friendly’s prescience long in coming. In the same Supreme Court of New York, in the same four-month span in 1964, came the head-on clash (in spite of a tortured attempt at reconciliation) of the two *Lionel*<sup>5</sup> and the *Republic*<sup>6</sup> opinions.

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1. This present article is the philosophical foundation for a companion study of the recent New York cases involving the sale of corporate control, Bayne, *The Sale-of-Control Quandary*, 51 Cornell L.Q. 1 (1965). The philosophy evolved herein, moreover, is essentially dependent on Bayne, *A Philosophy of Corporate Control*, 112 U. Pa. L. Rev. 22 (1963); Bayne, *Corporate Control as a Strict Trustee*, 53 Geo. L.J. 543 (1965). These studies provide citations to the principal commentaries in the field. The year’s refinement of thinking since “Philosophy” is manifest but should not derogate appreciably from the central core of reasoning in “Philosophy.”

2. 305 F.2d 572 (2d Cir. 1962).

3. *Id.* at 579-80 (Clark, J., concurring).

4. *Id.* at 580 (Friendly, J., concurring).

5. There are two distinct *Lionel* cases. The first was an action to set aside the election of *Lionel* directors. *Caplan v. Lionel Corp.*, Civil No. 19005, Sup. Ct. N.Y. County,

All three cases faced the same general question: Is the sale of corporate control by the seriatim resignation of the board *per se* illegal? This question will give the necessary filip to the construction of this philosophy of the sale of control. The detailed application of the resultant philosophy to the specific cases, *Essex Universal*, *Lionel* and *Republic*, is necessarily reserved for another time.<sup>7</sup> Here, perforce, these cases must remain in the background.

Even before the beginning, however, one major matter must be eliminated from consideration.

#### THE PREMIUM AND THE SALE

The source of considerable confusion enveloping the sale of control is the failure to make an essential distinction between two totally different questions: (1) may control ever be sold? and (2) if sold and if for a premium, to whom should go the premium? Is it the sale itself or the premium for the sale which engenders the illegality?

The destination of the premium is not the question here. *Ex arguendo*, the right of the collective shareholders to any genuine premium has been established elsewhere.<sup>8</sup> This presumption is, however, strictly *ex arguendo*, since the essential analysis of the sale may proceed on either hypothesis, of the legitimacy or illegitimacy of the premium. New York law is split on the subject. The majority holding characterized by *Essex Universal* permits a premium: "There is no question of the right of a controlling shareholder under New York law normally to derive a premium from the sale of a controlling block of stock."<sup>9</sup> But the first *Lionel* case, arguably distinguishable from *Essex*, held otherwise. Under some circumstances at least, "any bonus received for such transfer of their office [must] be returned to the corporation."<sup>10</sup>

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Jan. 30, 1964, aff'd, 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1st Dep't), aff'd mem. 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964). All three courts agreed that the election was illegal. The second case is a derivative action to recover for Lionel the premium received by Defiance Industries, Inc. in the transfer of control. *Gabriel Industries, Inc. v. Defiance Industries, Inc.*, (Sup. Ct.) in N.Y.L.J., June 17, 1964, p. 13, col. 8. The plaintiff's motion for partial summary judgment was granted.

6. *Carter v. Muscat*, Civil No. 7884, Sup. Ct. N.Y. County, May 21, 1964. No premium was involved. Special Term found the transfer of sale illegal. The appellate division affirmed. 21 App. Div. 2d 543, 251 N.Y.S.2d 378 (1st Dep't 1964).

7. The application of the philosophy appears in Bayne, *The Sale-of-Control Quandary*, 51 Cornell L.Q. 1 (1965).

8. Bayne, *A Philosophy of Corporate Control*, 112 U. Pa. L. Rev. 22 (1963); Bayne, *Corporate Control as a Strict Trustee*, 53 Geo. L.J. 543 (1965).

9. *Essex Universal Corp. v. Yates*, 305 F.2d 572, 576 (2d Cir. 1962).

10. *Caplan v. Lionel*, Civil No. 19005, Sup. Ct. N.Y. County, Jan. 30, 1964.

The core question—May corporate control ever be sold?—will find its answer in five stages: I. *The Nature of the Sale*; II. *The Definitions of Appropriator and Contrôleur*;<sup>11</sup> III. *The Power Bases and Geneses of the Custody*; IV. *The Fiduciary Duty in the Selection of the Contrôleur*; V. *The Proximate Norms of Selection*.

### I. THE NATURE OF THE SALE

The transfer of corporate control can be accomplished in several ways. The sale is merely one of them. The orderly, imperceptible transition of control from decade to decade in the established corporations, e.g., General Motors and A.T. & T., is the customary method. A shift of control may take place quietly and without incident at the annual meeting or may occur in a stormy proxy fight or a fraudulent seizure. Control passes in the sale of majority stock ownership. The sale, however, is the transfer of control to a successor in a particular, distinctive manner, presumably for some monetary or other consideration. None of the traditional types poses quite the subtle problems of a transfer by sale.

Yet the transfer of control by sale is not as recondite an operation as would first meet the eye. Strip away the terminology and the apparent complexities, and the transaction lends itself to a gratifyingly thorough understanding.

Begin with the question: What is the object of sale? The office? Scarcely, since the purchaser neither receives nor does the corporation part with the office. What is sold is the occupancy of the office, the position of *contrôleur*. This leads to an obvious conclusion. The object of sale is the appointment to the office.

The rationale and philosophy of the sale of control, therefore, are reducible to the principles and norms, ultimate and proximate, governing the selection of the officeholder. Ultimately, the legitimacy of the sale of control rests with the suitability of the appointed successor.

### II. THE DEFINITIONS OF APPROPRIATOR AND CONTROLEUR

Basic to any analysis of the sale is the pervasive control hypothesis: the complete separation of ownership and control. The owner, either willingly or unwillingly, appropriates his asset, the corporation, into the dominion of another. In so doing the owner at once becomes the appropriator and simultaneously appoints the *contrôleur* to the stewardship of the entity. Corporate control itself, therefore, is a relation of total custody between the office of *contrôleur* and the shareholders and the

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11. The terminology employed throughout this article is technical and is presented in Bayne, *The Definition of Corporate Control*, 9 St. Louis U.L.J. 444 (1965).

corporation, effected by the appropriation—forced or free—of the owner-become-appropriator.

By definition, the *contrôleur* has complete dominion, governs every act and asset. Control, if anything less than total, is not there but elsewhere. The *contrôleur* has the last word; is subordinate to no one, especially the appropriator; may solicit advice but need not, or once solicited need not heed it. Otherwise, corporate control would then reside, by definition, in the object of the compulsory consultation. Limited control is a misnomer and indicates that true control is in another. By rigid hypothesis the *contrôleur* is the indisputably ultimate authority. Unbelievably, this is an elusive concept.

The *contrôleur* has custody of *another's* property. It matters not, moreover, how small is the share owned by another. An infinitesimal amount constitutes the *contrôleur* a custodian. The *contrôleur qua contrôleur* is never an owner or appropriator, always a custodian.

This custodial concept is central to the philosophy of the sale of control. Preparatory, therefore, to the development of the norms for the sale of control, lies the task of discovering the source of this custody. The question is: Whence the custody?

### III. THE POWER BASES AND GENESES OF THE CUSTODY

The avenues are various by which the *contrôleur* assumes—and holds—his position. Some, most, are legitimate. Others are not. But for the present purposes no matter, because the *contrôleur* remains a custodian, licitly or not.

Beneath the actual appropriation of the corporation into the *contrôleur's* custody rest several bases or sources of the power requisite to effect such appropriation. The nature, location and function of these power bases have been left unclear by courts and commentators.

How can such an appropriation be accomplished? Where comes the capability? What makes such entrustment possible? The answer is fivefold. The power of appropriation can be founded on five bases.

The appropriator *qua* appropriator is by essential hypothesis completely distinct from the *contrôleur qua contrôleur*. But—and this causes confusion—as natural persons they may be one and the same. To forestall any such confusion all of the following hypotheticals will make the added often-contrary-to-fact separation of appropriator-*qua*-natural-person and *contrôleur-qua*-natural-person. This will aid the mind but could also mislead, because the reality of corporate life so frequently finds the same individual person as appropriator and *contrôleur*. Thus C. Russell Feld-

mann, as appropriator, owned thirty-three per cent of Newport stock, and was also the *contrôleur* of the firm.<sup>12</sup>

Note, the geneses of the custody are merely the result of the exercise of the power to appropriate. As a consequence, therefore, the five geneses are classed similarly, as effects to causes.

#### A. Total Ownership Appropriation

In the least complicated instance of control inception, a *contrôleur* may found his custodial position on the intentional appropriation of a 100 percent stock ownership. Such an appropriation may take any of many mechanical forms, *e.g.*, a voting trust, a proxy, a formal trust. The spin-off of a wholly owned subsidiary, through a totally dispersed public offering, would fit this pattern. The *contrôleur* qua *contrôleur* would own no stock whatsoever but base its dominion on the appropriator's 100 per cent stock block. The classic example of all time was the splintering of the Standard Oil empire into many separate entities.

#### B. Fifty-plus Per Cent Ownership

A *contrôleur* may have behind him an appropriator with sufficient stock to carry an annual meeting without any outside help. Such a majority—more than fifty but less than 100 per cent—under the democratic processes of the shareholders' meeting is an infallible power base for the *contrôleur*. Instances of such power positions are legion. "The theory of [Lebold] . . . was that [Inland Steel, the appropriator-*contrôleur*] . . . owning some 80 per cent of the stock of the Steamship Company, had so utilized its dominant position as majority stockholder as to force the latter company out of a prosperous going business . . . and to take over its property . . ." <sup>13</sup> So also was the foundation of the *contrôleur* position in the famous *Deep Rock* case,<sup>14</sup> *Sterling v. Mayflower Hotel Corp.*<sup>15</sup> and *Pepper v. Litton.*<sup>16</sup>

#### C. Mere-Incumbency Control

Although the philosophy of control patently has applicability wherever control is involved, its usefulness reaches the maximum in that

12. *Perlman v. Feldmann*, 219 F.2d 173, 174 n.1 (2d Cir. 1955).

13. *Lebold v. Inland Steel Co.*, 125 F.2d 369, 371 (7th Cir. 1941).

14. *Taylor v. Standard Gas & Elec. Co.*, 96 F.2d 693 (10th Cir. 1938). "Standard owned substantially all of the common stock" of *Deep Rock Oil*. *Id.* at 697.

15. 33 Del. Ch. 293, 93 A.2d 107 (Sup. Ct. 1952). Hilton owned "nearly five-sixths of the outstanding stock." *Id.* at 296, 93 A.2d at 108.

16. 308 U.S. 295 (1939). "Litton as the dominant influence over *Dixie Splint Coal Company* used his power not to deal fairly with the creditors of that company but to manipulate its affairs . . ." *Id.* at 311-12.

bizarre class of cases: control by mere incumbency. Here is the stumbling block for the New York courts. In this one latter-day phenomenon of corporate evolution probably lie the major insights—as obvious as they are upon statement—toward an understanding of the transfer by sale.

The fortuitous combination in the widely held corporation of two seemingly salutary and innocent forces has provided the management *contrôleur*, through incumbency alone, with a power base as absolute and firm as would 99.99 per cent stock ownership. The factors: (1) the solicitation system (corporate personnel, mailing facilities, finances), and (2) the broad dispersal of shares. Neither alone gives control. The combination is necessary.

Several unsettling factors contribute to the firmness of this power base and put the *contrôleur* in an unassailable position and the appropriator under a double disability: (1) full and effective disclosure is generally impossible, and (2) if possible, the appropriator lacks the acumen and *savoir* to utilize it (a questionably remediable situation). Thus, though the appropriator may have willingly entrusted the entity to the *contrôleur* in the early dawn of the corporate history, his appropriation now is willy-nilly.

Note well, here the tenure of the *contrôleur* is not founded on corporate democracy but on mere incumbency, presumably a *legitimate* mere incumbency.

The two classes of incumbency control do not differ in kind, only degree. The key to the difference is the stock diffusion. These two classes constitute the third and fourth types of power bases of the custody of the *contrôleur*.

### 1. The A.T. & T. Type of Mere Incumbency

At one antipolar extreme, stand those corporations (*e.g.*, A.T. & T. and U.S. Steel) where a single appropriator never approaches a one per cent stockholding. These are prototypical of incumbency control.

At this A.T. & T. extreme, an added factor creates the difference in degree (or kind?). As the diffusion decreases, so also does the difference. With the appropriators so completely unorganized, the power base of the management *contrôleur* is not only rocklike and immovable but perpetual as well. Here the breadth of dispersal virtually forecloses even a proxy fight. Who would retrace the travails of Louis Wolfson or Robert Young?

Until the corporate system changes, such incumbent *contrôleur* either carries forward or resigns. His power position is virtually invulnerable.



The result: an impregnable and hence permanent, self-perpetuating *contrôleur* sustained in office by mere incumbency.

This does not mean to endorse or damn the system. It merely faces life and concludes to a (1) strong, and (2) permanent power base for the incumbent management *contrôleur*.

## 2. Tenuous Incumbency Control

At the other pole the diffusion is less pronounced, but nonetheless is by definition the determinative factor, although less stable, in the *contrôleur*'s position. In a percentage distribution of 40-40, the dissipation of the remaining 20 per cent undeniably lodges control in the incumbent *contrôleur* whether he himself is one or the other of the 40 per cent appropriators.

Obviously the supposition here is the absence of a coalition between the two 40 per cent appropriators. Such coalition would throw the situation into the democratic, majority-*contrôleur* category.

Further, with one 40 per cent appropriator *ex hypothesi* invariably dissident, the prospects of a proxy fight are far greater. Either dissentient appropriator, with a 40 per cent stock base, has fewer obstacles to overcome toward inducing the dispersed shares to vote with his block. As imminent as a proxy battle may be, however, it is the diffusion which tips the scale in favor of the incumbent *contrôleur*, and control still rests with him who issues the proxy statement.

Whether or not the junction of the solicitation system with the diffusion of shares actually is the ultimate determinant of control in such a 40-40 situation is always a question of fact. If determinative—the assumption here—the result is a power base of tenuous mere incumbency. If not, a coalition creates a base effected by a majority stock holding. No need to fight the facts.

Furthermore, merely because the person occupying the office of *contrôleur* may change quickly does not mean that someone is not in the office or that his occupancy is not determined by mere incumbency. Whether he is someone or another matters nil in concluding to: (1) his presence, and (2) his complete dominion and custody as *contrôleur*.

Although this second type of incumbency base differs from the first in the imminency of a proxy contest, the two are one in the sheepishness of the appropriators. Any difference in the capacity of the appropriators to shift control does not affect the presence of the control, merely its inviolability. In the A.T. & T. class, attempted reassertion of control by the appropriators is vain. Here the lesser diffusion—and hence the capacity of the appropriators—may keep the *contrôleur* under a cloud, but his dominion is nonetheless absolute.

A valid question arises: What powers and rights does the dissident 40 per cent appropriator have in such situation? Or suppose several dissentient appropriators with varying percentages, say 20-20-15-15. What is their voice in the face of a *contrôleur* who is incumbent through the wide dispersal of the 30 per cent? The answer: The amount of stock of any one block is irrelevant to the autonomy of the chosen incumbent *contrôleur*. The various blocks, their size and potential liaison, may be a threat to the *contrôleur*'s continued custody, but as incumbent he still has a dominion that is 100 per cent absolute.

From the standpoint of the dissident appropriators, no one or another block has the right to advise or counsel, dictate policies or decisions, since no one is actually the *contrôleur* or is large enough to oust the incumbent by majority vote. *Ex arguendo*, why one block rather than another? Is size, less than a majority, to be determinative?

The full answer lies in the essence of the control form of corporate government. Ultimately, it is reducible to the nature of control and the absolute necessity for some one governing person, a *contrôleur*. The ultimate policy-making power must be vested in some one. The disunity in any other formula would be chaotic.

Through the operation of the present corporate system, this particular management, by mere incumbency, has become the governing *contrôleur*, with total custody. This management, therefore, not only has no obligation to consult with or follow any block, but has the fiduciary duty of making its own decisions, of exercising its own stewardship, of fulfilling to the fullest the demands of the custody it assumed.

#### D. *Blackmail & Duress*

All types of illegitimate assumption of custody could be grouped loosely together. These power bases obviously can be located within the context of the other four forms. An illicit seizure of dominion over the entity may be achieved by means of corporate democratic processes of a majority vote or by a perversion of the mechanics of mere incumbency control. Through wiles and stratagems the *contrôleur* may be duping the naive or the uninformed. By blackmail and extortion he may dominate a 100 per cent owner. In short, many are the ways in which the "power to transfer control . . . [may] be secured unlawfully, as, for example, by bribe or duress."<sup>17</sup> These extracorporate methods, however, offer a source of power as effective as legitimate ownership or share dispersal.

This concludes the preparatory elaboration of the five power bases and geneses of *contrôleur* custody. The point throughout has been the

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17. *Essex Universal Corp. v. Yates*, 305 F.2d 572, 580 (2d Cir. 1962).

same. Whether founded in 100 per cent ownership, majority ownership, or nondemocratic mere incumbency, whether tenuously held or firmly, permanently or fleetingly, whether by fraud or chicanery, in every case the dominion and custody of the *contrôleur* is total. Whatever the means of first assumption—licit or no—whatever the means of perpetuation—licit or no—in every instance the *contrôleur* is completely a custodian. By retention of dominion he has acquiesced in the appropriation and assumed that full stewardship of the corporation. In the very act of acknowledging this custody, he also acknowledges the obligations flowing from the custody. His is the duty, therefore, of the custodial office of *contrôleur*.

The way is now cleared for the central problem in the transfer by sale. How does the broad responsibility of the office translate itself into the specific obligations surrounding the transfer of control? As a strict custodian, what norms or standards of suitability govern the *contrôleur* in the selection of his successor pursuant to the duty of his office?

Antecedent to subjection to the test of successor suitability, the incumbent *contrôleur* faces the legal scrutiny of the legitimacy of the power basis and genesis—as well as the continued tenure—of his control. Although an illicit *contrôleur* has escaped the sanctions at any prior stage, he is nonetheless incumbent, nonetheless a custodian, and faced with the same obligations of the office as his legitimate counterpart. The illegitimacy of his power base, his genesis, or his tenure, does not mean, by that very fact, that his performance of these obligations will be deficient or that, more to the point, his selection of a successor in the transfer of control by sale will thereby be judged a bad one—or a good one.

#### IV. THE FIDUCIARY DUTY IN THE SELECTION OF THE CONTRÔLEUR

The custody of the corporation assumed by the *contrôleur* has engendered a complexus of duties, collectively described as the fiduciary duty of control, which coalesce in one overall obligation: the *bonum commune* of the corporation and its shareholders. The *contrôleur* has undertaken to guard, guide, nurture as his own, this asset entrusted to him. He must strive to produce the best possible corporation.

Elsewhere this objective of the corporate general welfare has been aptly divided into three major goals: (1) the most appropriate corporate structure; (2) the most enlightened managerial policy; and (3) the selection of the finest personnel.<sup>18</sup>

Integral to this third division of the *contrôleur's* fiduciary duty is the selection of the most suitable successor. As important as is the chairman,

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18. Bayne, A Philosophy of Corporate Control, 112 U. Pa. L. Rev. 22, 43 (1963).

the chief executive officer, the operating head, the board, nevertheless, the role of the successor to the *contrôleur* is transcendent. Those norms of selection of personnel that guided the incumbent *contrôleur* during tenure, guide him as well in departing that tenure, in the proper and beneficial transfer of control. The choice of a successor is undeniably the crowning act of the *contrôleur*'s career, as well as his last, and hence invites the commensurate scrutiny of the standards of a fiduciary. In fine, this study is merely another facet of the fiduciary duty of the *contrôleur*.

Writing to the author fifteen years ago, Nathan Lobell characterized appositely the role of the *contrôleur*:

The whole problem of corporate management is a facet of our latter-day split between ownership of wealth and the control thereof. But, if our experience at the S.E.C. has been in any sense typical, the really crucial ethical problems that have arisen in dealing with corporate management have grown out of management's ownership of a stake in the enterprise. While we once stood at the crossroads facing, on the one hand, the path of merging management responsibility with management's stake in the business and on the other, the creation of a class of disinterested fiduciaries, we have—whether we like it or not—taken the second road. It no longer makes any sense to require that either a substantial portion of corporate wealth be owned by the management or that a substantial portion of management's wealth be invested in the corporation. The hope for effective and honest management lies in evolving a class of financially disinterested managers who accept, as part of a working code, the simple rudiments of honest politics.<sup>19</sup>

#### V. THE PROXIMATE NORMS OF SELECTION

The *contrôleur*'s fiduciary duty in the selection of a successor may be specified further in three stages: (1) the proximate norms of selection; (2) the *indicia* of breach; and (3) possible remedies for breach.

Here is the final resolution of the question posed by the sale of control: Did incumbent *contrôleur*'s selection conform to the proximate norms integral to his fiduciary duty? The answer is the answer to the legitimacy of the sale. All other questions have been preliminary.

Prior to any enunciation of the norms of suitability, the philosophical thrust of this study should be given concrete expression in a major presumption—the *presumption of propriety*:

Until rebutted, a presumption exists at law that the selection of a successor, when made by the incumbent *contrôleur* pursuant to the duty of appointment, is conformable to the proximate norms of propriety and suitability.

Such a rebuttable presumption, or at least inference, is the only logical conclusion from either a legitimate or an unchallenged illegitimate

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19. Letter From Nathan D. Lobell, then Executive Advisor to the Securities and Exchange Commission, to the Author, February 7, 1949.

custody. A basic working premise should be that he who occupies an office is fulfilling its duties until shown otherwise.

The efficacy of any preliminary attacks on the incumbent contrôleur's *right to appoint*, founded on the illegality of initial accession or tenure, is within the judgment of the court and is to be determined upon traditional law. In short, a vast difference exists between the *right to appoint* and the *suitability of the appointee*. The illicit contrôleur may appoint a superb successor, his licit counterpart, an oaf.

#### A. *The Proximate Norms*

Descent to minutiae in delineating the proximate norms is neither advisable nor feasible. The personal qualities required of the corporate contrôleur may be adequately presented in a five-part working pattern for *ad hoc* application: (1) moral integrity; (2) intellectual competence; (3) managerial and organizational proficiency; (4) social suitability; and (5) satisfactory age and health. Absent, therefore, a proven legal and substantial deficiency in these qualities, the presumption of propriety prevails.

#### B. *The Indicia of Breach*

The proximate norms (and any concomitant presumptions) are applied according to established tort formulas. The selection may be either intentionally or negligently improper.

Remember that these norms govern the choice of a man for an office. The breach of these norms consists in the choice of an unsuitable person. The indicia of breach are signs pointing to such a person. The transfer by sale may entail many another matter—from a subtle swindle to bald fraud—which is legally reprehensible in its own right. Here, however, the question only concerns the suitability—or lack of it—of the man for the job. Some of the discernible guidelines:

(1) *Predictable Spoliation*. Foreseeable raiding by the successor may constitute either an intentional (including the "substantial certainty" of the new section 8A of the Tentative Draft of the *Restatement of Torts*<sup>20</sup>), or a negligent tort.<sup>21</sup> The extent of admissibility of post-factum activity by the successor, e.g., how much and what kind of looting, how many years later, etc., is a question for the discretion of the court.

(2) *Self-Financing*. Closer scrutiny should be given to an appointee in a deal in which he repays the amount borrowed for the purchase price of the stock with the assets of the controlled corporation.

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20. Restatement, Torts, § 8A at 1 (Tent. Draft No. 1, 1957).

21. See, e.g., *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940); *Gerdes v. Reynolds*, 28 N.Y.S.2d 622 (Sup. Ct. 1941).

(3) *Projected Mergers or Acquisitions*. Motives other than corporate welfare (and hence an indication of the unsuitability of the appointee) could be present in proposals for self-serving purchases (by the controlled corporation) of outside corporations owned or controlled by the new *contrôleur* appointee.

(4) *Questionable Salary Contracts*. Employment agreements accorded the outgoing *contrôleur* (consultative positions) or the new appointee, that may be *per se* legal but are nonetheless suspect, may be overreaching on either side.

(5) *Fringe Benefits*. "In considering the advantages of control . . . we are not primarily concerned with advantages from the possible illegal actions. However, there are many possible actions which . . . are either legal or on the borderline."<sup>22</sup> This *Green Giant* summary of "the advantages of control"<sup>23</sup> listed several "specific areas of such action" as "contracts with suppliers or agents," the use of corporate trademarks, the opportunity "to obtain the largest salary that could not be attacked in the courts plus other perquisites of the office including such things as stock options, pensions, insurance coverage, et cetera."<sup>24</sup> All of these objectives—especially the spirit that would envisage actions "on the borderline"—would be proper to a man of questionable suitability for the office of ultimate custodian of a corporation.

(6) *The Appointee's Character*. Since the entire question of the selection is reducible to the general character of the man, it is perhaps inaccurate to segregate personal qualities as a separate guideline. However, the reputation of a person may be so egregiously malodorous, *e.g.*, emotional instability, alcoholism, notorious immorality, gambling, as to constitute a distinct indicium. (These indicia could not hope to be exhaustive. Nor need they be. Deficiencies in intellectual competence, managerial efficiency, age and health, require no particular earmarks for detection.)

(7) *The Presence of a Premium*. The last indicium possesses such intrinsic cogency as to elicit a presumption:

The presence of a bona fide premium in the sale of control raises a strict legal, albeit rebuttable, presumption that the selection of a successor *contrôleur* is violative of the proximate norms of the fiduciary duty of the incumbent *contrôleur*.

Admittedly the entire force of this presumption is attributable to the illegality of the premium (which necessarily has been left for proof elsewhere<sup>25</sup>). (Note, however, that the remaining reasoning by no means

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22. Record, p. 338, *Honigman v. Green Giant Co.*, 309 F.2d 667 (8th Cir. 1962).

23. *Ibid.*

24. *Id.* at 340.

25. The major premises have already been established in *Bayne*, *A Philosophy of Cor-*

stands or falls on this presumption. Rebut the presumption, or refuse to make it; nevertheless, the question of general suitability, irrespective of a premium or a premium presumption, must be answered.) As illegal, such a premium (when paid by a culpable purchaser) can only point to a person prepared to take illegal means to gain appointment to the office. A reasonable query would then be: Does not a tainted acquisition raise at least a presumption of further illegal activity (or else why the premium)? Or, which is the point here, of at least questionable integrity and hence suitability? This premium presumption will countervail the incumbency presumption of propriety and shift the burden to the defendant.

Certain influential factors, evolved from the philosophy underlying these presumptions, could be formulated into subrules. Thus, as the security of the tenure of the outgoing *contrôleur* (evidenced, *e.g.*, by more or less stock backing) decreases and the premium increases, scrutiny of the appointee should be heightened. Contrariwise, the stronger the incumbent's stock position and the lower the premium, the less suspicion of impropriety.

A rebuttal of the premium presumption, by use of a hypothetical case, will add perspective to its validity. Envisage two moral and conscientious businessmen with laudable aspirations for the corporation, a buyer and a seller of corporate control, who honestly subscribe to the position (the present New York law, as a matter of fact, in spite of writings to the contrary) that a *contrôleur*-shareholder normally may derive a premium from the sale of a controlling block of stock. With this understanding, a sale is consummated. Here the presence of a premium is nowise probative, or even indicative, of the unsuitability either of the incumbent *contrôleur* or of his appointee. If these facts are buttressed (or even if they are not) by the restoration of the premium to the corporation by the outgoing *contrôleur*, the premium presumption immediately falls and the initial presumption of propriety reapplies. The question then reverts simply to the suitability of the man for the job. If suitable, he should stay on, the premium notwithstanding.

Further, recall that a "premium," which is in effect only deferred compensation justly owed to the outgoing *contrôleur*, is not a premium at all. The assumption here is that the premium is purely a bonus for the appointment to the office.

Another insight may clarify further. A source of suspicion is built into every transfer by sale. Almost invariably the transfer is accompanied

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porate Control, 112 U. Pa. L. Rev. 22 (1963); and more particularly in Bayne, Corporate Control as a Strict Trustee, 53 Geo. L.J. 543 (1965). A specific treatment is planned.

by the sale of some stock by the outgoing to the incoming contrôleur. The price paid may or may not include a premium. Since money always changes hands, the question inevitably arises: Was the payment simply the market value or did it include the suspicious premium as well? If the incumbent contrôleur, without any stock sale, had entrusted control to the suitable successor, obviously no presumption would ensue.

For example, Frederick R. Kappel, as putative corporate contrôleur of A.T. & T., determines that a top executive of General Tel. & El. is exactly suited for A.T. & T. No eyebrows would be raised and no presumption would arise if the transfer was made without any sale of stock at all. If Mr. Kappel and his successor did see fit to exchange the relatively few Kappel shares, at the existing market, certainly this, likewise, would arouse little concern.

The recent spin-off of the Ethyl Corporation from its General Motors-Standard Oil corporate syndicate was conjecturally just such a transfer. The GM-ESSO appropriator of Ethyl could be presumed to have determined that the management of minuscule Albemarle Paper of Virginia was amply endowed with the abilities to guide Ethyl's future. Upon assurances by GM-ESSO of the transfer of control to Albemarle, little or no difficulty would be entailed in securing adequate financing. Here is an arresting instance of a legitimate transfer, without semblance of premium or impropriety.

Even more intriguing, and totally independent of conjecture, is the late 1964 transfer of control of Weyenberg Shoe by Mr. F. L. Weyenberg (controlling 51.3 per cent of the common stock) to young Thomas W. Florsheim. Here was a perfectly legitimate contrôleur appointment, highly illustrative of the fundamental philosophy of this article.<sup>26</sup>

This inherent disability—the invariable sale of stock—in every sale of corporate control is not present in the control transfer in a strict trust. Thus, shenanigans are readily discernible in the sale of a trust office. Since money should never be involved, the moment money does change hands, without doubt (1) a genuine premium (and not merely the market price of some stock) has been paid for the appointment, and (2) such a premium carries by that fact a suspicion of chicanery (as a bona fide premium does in the sale of the appointment to the office of contrôleur).

This explains why the fascinating case of *Sugden v. Crossland*<sup>27</sup> is at once extremely helpful as a trust-control parallel and dangerously deceiv-

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26. See Prospectus, Weyenberg Shoe Manufacturing Company, October 15, 1964, Registration Statement File No. 2-2280, Securities and Exchange Commission, Washington, D.C.

27. 3 Sm. & Gif. 192, 65 Eng. Rep. 620 (Ch. 1856).



ing as a precedent for corporate-control adjudications. In *Sugden*, the incumbent trustee, against the manifest wishes of the settlor, purely and simply sold an appointment to the office to a third party for £75. The £75 was not only a premium (which the court ordered into the trust fund) but thereby also a sound tip-off that something was awry. As the truth would have it, the presumption raised by the premium was well founded. The court removed the purchaser from the office as unsuitable. His qualifications for trustee had previously been considered by the settlor himself and found wanting. The incumbent trustee had doubly breached his fiduciary duty (1) in taking £75 for simply doing his job, and (2) in appointing an incompetent to office.

Thus *Sugden* is a valuable precedent for corporate control when a bona fide premium has been legally segregated from the market value of the stock. But *Sugden* may mislead. The premium is openly visible in a trust case but not in the corporate sale of control. Whenever and always, if money passes in a trust deal, it is a premium. Not so in the transfer of control. Valuable stock may accompany a control transfer.

However, do not forget that in *Sugden* as well as in the corporate sales the premium presumption is always rebuttable. If both parties (or at least the purchaser) thought the premium was both justifiable and legal (although the simplicity of the trust makes this almost a contrary-to-fact condition), the proof of the suitability of the appointee could go forward. Thus it must be decided first if any premium is present; then, whether the purchaser was culpably conscious of the illegality.

Are there any other factors, beyond the personal qualifications of the *contrôleur*, that could render the transfer of control illegal? None. Since the *contrôleur* has complete mastery of the entire deal, any consequent actions (and nonconsequents are not attributable to the sale) are inexorably referable to the suitability of the successor. What tends to confuse here is that the gross evidences of unsuitability (looting, fraud, bribery, duress) are sufficient to vitiate the deal without reference to the qualifications of the appointee. This does not mean, however, that they are not thereby the direct effects of the appointee's deficiencies (here, moral deficiencies). The logic of the analysis (*i.e.*, the reduction of the legitimacy of the transfer exclusively to the personal qualifications of the appointee) proves its unerring efficacy when applied to the subtler deficiencies (which might escape a court if not viewed in the framework of the personal qualifications of the man), *e.g.*, a propensity to indulge not in "possible illegal actions" but in the "many possible actions which . . . are . . . on the borderline."<sup>28</sup> Only an evaluation of the personal qualifications

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28. Record, p. 333, *Honigman v. Green Giant Co.*, 309 F.2d 667 (8th Cir. 1962).

of the man will encompass both the palpable crimes and the elusive deficiencies. In the end, the overall acceptability of the candidate is the sole, ultimate norm of the legality of the sale of control.

C. *The Remedies for a Breach*

The established legal remedies warrant little comment. The distinction, however, between the respective culpability of the outgoing and the incoming contrôleur governs their respective liability. The appointee may have innocently paid a premium and hence may remain in office. The prior incumbent, however, may have either received or retained a premium illicitly and hence would be liable in damages even though no injunction would lie for the removal of his appointee.

This concludes the synthesis of a philosophy of the sale of corporate control—those “abstract moral principles” so necessary for application to the day-to-day problems arising in the emerging control field.