One seeking to acquire control of an existing corporation's operations is not confined to buying all of its assets or merging it into another corporation. He may simply buy a sufficient number of voting shares to give him the "control" he desires. The purchase of a majority of voting shares brings power to elect at least a majority of the

* A Table of Contents for this article is appended at pp. 840-41.
† Associate Professor of Law, University of Pennsylvania Law School.
1. See BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 69 (1933). The "control" of a corporation resides in that person or group of persons which in fact determines the corporation's operational and financial policies with minimum practical risk of effective reversal of policy decisions. In that sense, the subordinate corporate official who has broad discretionary authority in the particular area of corporate activity committed to him does not control that part of the corporation, so long as the ambit of his authority is in practice circumscribed by others and his decisions subject to effective review. Nor do scattered and unorganized holders of a majority of the corporation's shares control the corporation, however potential their control may be. For the most part, control rests in that person or concerted group of persons who hold majority shares or occupy a position in the corporate machinery which facilitates their garnering majority shares. Such a person or group can select at least a majority of the board of directors, the technical repository of the decision-making function in the corporation. As demonstrated in the work cited above, there are numerous devices by which control (i.e., the practical ability to select the board of directors) may be exercised. This article is concerned with the control which is exercised through ownership of a majority of the corporation's shares or of a large minority block of such shares. Of course, the mere process of collection of a large minority block of shares does not guarantee that control may be wrested from a management which has been able to administer the proxy machinery to acquire voting majorities. But once such a block has assumed management through a proxy fight or otherwise, its hold on the board of directors is practically insured so long as a scattered majority acquiesces in its retention. Practical control thus may rest in a large minority block of shares not only because of the difficulty of organizing opposition to the block (and to the shareholder adherents it has acquired by inertia) but also because attempts to organize that opposition are still not commonplace.
directors and thereby to determine the day to day policies of the business. Even a large block of minority shares may give the buyer as much freedom, for if there is no similar concentration of shares outstanding and the majority shareholders are sufficiently scattered to make organized opposition unlikely, the buyer may find that he can use the proxy machinery to install directors of his own selection.

The buyer may acquire the shares necessary to give him control in a variety of ways, including open market purchases and invitations of tenders from outstanding shareholders. If he is looking for a shortcut, he may deal directly with the corporate management or with someone who already owns a block of majority or minority shares large enough for his purposes. In such cases, participation by the management or the controlling shareholders in the buyer's acquisition of control creates problems of significance and difficulty in corporation law. It is the purpose of this article to examine transactions involving the acquisition of controlling corporate shares in the light of possible causes of action against members of management and controlling shareholders who facilitate such acquisitions.

Two major factual situations are to be considered. Part One covers cases such as the following: $D$ is a member of the management of Corporation $C$, or the holder of a controlling block of $C$'s shares, or both. Buyer wishes to acquire control of $C$ by purchasing shares. $D$ may sell his own shares, if he has any. At the same time he may either buy other outstanding shares for resale to Buyer or advise, or in some other fashion assist, other holders of outstanding shares to sell to Buyer. Possibly, $D$ may do nothing more than sell his own shares, while Buyer makes his own arrangements with the other shareholders for acquisition of their shares. The outstanding shareholders (other than $D$) whose shares are thus purchased in connection with Buyer's acquisition of control may for convenience be referred to collectively in this article as "selling shareholders." The problem to be considered is whether or not the selling shareholders have any cause of action against $D$ and, if so, under what refinements of the circumstances mentioned above.

Part Two covers primarily those cases in which $D$, the holder of a controlling block of shares (either majority or minority), sells his own shares to Buyer; the latter does not necessarily purchase the shares of other shareholders. Those whose shares are not included in the sale and who thus continue to be shareholders after the transfer of the

controlling shares may for convenience be referred to collectively in this article as "remaining shareholders." The problem to be considered is whether or not $D$, the seller of controlling shares, is liable either to the corporation or to the remaining shareholders and, if so, under what circumstances.

A third factual situation may arise, involving a combination of the two foregoing cases. $D$, the holder of controlling shares, sells his controlling block; some, but not all, of the other holders of outstanding shares sell their shares to Buyer. Thus there is posed the problem of the integration of the possible remedies of three interested groups: the selling shareholders, the remaining shareholders and the corporation. That problem also is examined in Part Two of this article.

The formal transaction giving unity to all of the cases considered is a transfer of shares. Beyond the merely formal, however, each such share transaction results in the vesting of control in the buyer. This two-fold characteristic has created difficulty in the analysis of cases in this area. In the main, corporate shares have been considered by their holders, as well as by many courts, as constituting merely one species of personal property which the owner is free to dispose of as his inclinations may dictate. However, recognition in recent years that corporate control is a fact capable of isolation and identification has caused courts to view its transfer by way of share transactions as a matter essentially different from an ordinary purchase or sale of shares. Courts have begun to focus attention on the responsibilities of those who hold control and transfer it, or who have it within their power to aid the buyer to acquire control from scattered shareholders. Those peculiarly in that position are controlling shareholders and managers. As a result of judicial attention to this problem, controlling shareholders have discovered that they may be subject to liabilities which they thought did not rest on them. In addition, the relative immunity which management has had with respect to share transactions has been disappearing.

Judicial examination of control transactions as such, rather than merely as share transfers, has come about slowly. Courts have dealt with the problems of control transfers in the light of common-law doctrines seldom designed to encompass transactions involving the peculiar...
fact of corporate control. As a result the bases of decision are frequently unclear. Some assistance in the solution of the problems in this area has come by way of the federal securities statutes. Therefore, it is the plan of this article to consider first the judicial handling of particular problems under state law and to follow with a consideration of the impact of the federal statutes upon the same fact situations.

Since, as has been suggested, the problems in this area were initially viewed merely as share transfers, it is not surprising to note that it has been a painfully slow process for the courts to impose new responsibilities on a distinct type of shareholder, the controlling shareholder. On the other hand, more ease in holding directors and officers to strict standards of conduct, even in share transactions in general, might have been expected: they were, after all, charged with a high degree of responsibility for the welfare of the enterprise from the outset. Even with respect to directors and officers, however, imposition of such high standards in control transactions has not been automatic.

Initially it is necessary to consider a fundamental assumption which underlies many of the cases with which this article is concerned. That assumption is that it is not desirable to foreclose those who occupy managerial positions from acquiring shares in the corporations in their charge. Conceivably the law could have developed in a contrary direction. As it became obvious that there was increasingly less identity between the managers and the owners of corporate property, it might have been concluded that complete segregation of management and ownership would be more desirable than managerial ownership of only a partial interest in that property. The argument could have run as follows: directors and officers should represent the whole body of shareholders. An owner of shares may at times find his interests opposed to those of fellow shareholders, particularly when he is buying and selling shares. A manager who owns shares may find his personal interests no less opposed to those of other shareholders and may, indeed, seek to use corporate machinery to advance those personal interests. Therefore, to guarantee concentration of endeavor on behalf of all shareholders, the possibility of personal temptation in any case should be removed by a rule forbidding managerial share ownership in all cases.


5. See Berle & Means, The Modern Corporation and Private Property 225 n.6 (1933).
In the development of modern corporate policy, that argument has been rejected, if indeed it was ever seriously considered. At least equally plausible is the argument that managers who do not own some interest as shareholders will be more inclined to use the corporation for their own benefit than will those who, as shareholders, are affected by whatever the corporation does. Statutes which require directors to own "qualifying" shares retain the vestige of an assumption that ownership of even a small part of an enterprise is a mild inducement to better management. The practice of granting options to managers to purchase shares at favorable prices has been justified in part on the ground that management's acquisition of a stake in the enterprise gives it an incentive to operate it consistently with investor interests. Not the least significant reason for the continuance of the basic assumption is the desire to inhibit freedoms only to the extent that their exercise is positively injurious to some common objective of society. In management's ownership per se of corporate shares, there has been no discernible risk of injury to any such objective.

Ownership of shares has implied some freedom to trade in them. As will appear later in this article, the courts are not agreed on the appropriate extent of that freedom so far as manager-shareholders are concerned. They are agreed, however, that the fact that a person is a corporate manager will not serve alone as the basis for imposing a sanction on him for trading in his corporation's shares unless a regulatory statute dictates otherwise. The freedom permitted to a manager to trade in shares appears to go so far as to permit him to buy shares for the purpose of accumulating a sufficient number to acquire control of the corporation, a freedom similar to that accorded to the complete outsider. No shareholder whose shares have been bought by a manager seeking to acquire control has successfully complained solely on the ground that the one who purchased was a manager.

6. See Dean, Employee Stock Options, 66 Harv. L. Rev. 1403, 1404 (1953).
7. E.g., §16(b) of the Exchange Act, 48 Stat. 896 (1934), 15 U.S.C. §78p (1952). Even under §16(b), a beneficial owner, officer or director subject to its provisions will be required to account for his profit only if the profit is realized by trading activities within a period of less than six months. See also SEC v. Chenery Corp., 332 U.S. 194 (1947) (proceeding under the Public Utility Holding Company Act of 1935, 49 Stat. 803 (1935), 15 U.S.C. §79 (1952)).
8. Adams v. Mid-West Chevrolet Corp., 198 Okla. 461, 179 P.2d 147 (1947); Howell v. McCloskey, 375 Pa. 100, 99 A.2d 610 (1953). In Guaranty Laundry Co. v. Pulliam, 198 Okla. 667, 181 P.2d 1007 (1947), the court rejected one argument which, if recognized, would constitute a substantial restriction upon a manager's purchasing any shares, controlling or otherwise; the contention rejected was that an officer may not purchase shares without first affording an opportunity to other officers and shareholders to share in the purchase.
10. See SEC v. Chenery Corp., 318 U.S. 80, 88 (1943). A manager may be called to account to the corporation for the purchase of the corporation's shares on his own
When such a purchase of shares is examined in the light of the circumstances under which it was made and the purpose for which controlling shares were acquired, entirely different considerations come into play. What risks are faced by a manager, or even a controlling shareholder, who purchases shares to carry out a plan to vest control in a third party? If the third party's purchase of control is cast in some form other than a purchase and resale of shares by the manager, or by the controlling shareholder, are those risks altered? The first part of this article is concerned with such questions.

**PART ONE. ACTIONS BY SELLING SHAREHOLDERS**

I. Actions Under State Law

A. Actions Against Managers or Controlling Shareholders Who Purchase for Resale or Advise Sale to Buyer of Control

Assume that Buyer wishes to acquire undiluted control of Corporation C by purchasing all of its outstanding shares, consisting of 50,000 shares of common voting stock. He is willing to pay $200,000 for all of the shares, an average of $4 a share for all those outstanding. He discusses the matter with a member of the corporate management or with someone (not necessarily an officer or director) who already owns a majority or controlling minority block of shares. If it may be assumed that sales of Corporation C's shares have recently been made at or around $3 a share, the manager or controlling shareholder may do several things, the following two of which may now be considered:

**Case A. Selling Shareholders Do Not Know That Buyer Is Acquiring Control.** D (the manager or controlling shareholder) contracts with Buyer to deliver all of the outstanding shares at Buyer's price ($200,000) or keeps the negotiations with Buyer open. Then D buys any outstanding shares which he does not presently own, paying approximately $3 a share for them. The selling shareholders do not know of D's prospective profitable resale to Buyer. D eventually delivers all of the Corporation's behalf when he has used corporate funds to make the purchase: Ashman v. Miller, 101 F.2d 85 (6th Cir. 1939); Ashley v. Keith Oil Corp., 73 F. Supp. 37, 47 (D. Mass. 1947) (defendant had also disabled corporation from purchasing the shares which he bought on his own behalf); or at a time when the corporation has directed him to purchase its shares on its behalf: Hauben v. Morris, 255 App. Div. 35, 46, 5 N.Y.S.2d 721, 730 (1st Dep't 1938) (dictum).

11. In deciding how he may best acquire C's business, Buyer may consider a merger or a purchase of all the assets. He may reject those methods in favor of a purchase of shares because of the applicable corporation statute; if that statute permits shareholders dissenting from a merger or sale of assets to withdraw from the corporation upon receiving the appraised value of their shares, there is the possibility that a large number of shareholders may dissent and thereby drain the corporation.
shares to Buyer for $200,000, averaging $4 a share, all of which D retains.12

Case B. Selling Shareholders Do Not Know Price at Which Buyer Is Acquiring Control. D either contracts with Buyer to use his best efforts to see that all of C's shares will be delivered to Buyer or keeps the negotiations open. Then D tells other shareholders about Buyer's desire to acquire all of the shares and advises them to sell or acts as their intermediary for delivery of their shares to Buyer. D does not tell them how much Buyer is willing to pay to acquire control. All of the shares are eventually delivered to Buyer, who expends a total of $200,000 or an average of $4 per share. But selling shareholders other than D have received only $3 a share while D has received all of the rest, either as a "bonus" or as a higher "price" per share for his own shares.

Has the manager or controlling shareholder incurred liability to the selling shareholders in either of the above two cases?13

The foregoing transactions raise problems concerning the structure of the corporation as an institution and the interrelationship of its component parts. No mere purchase and sale of shares is involved; the entire enterprise as a going concern is purchased by someone willing to pay a highly favorable price. A business opportunity of a

---

12. D might persuade Buyer that effective control could be obtained without purchasing the presently outstanding shares. If D should seek to acquire a sufficient number of shares to satisfy Buyer's needs, by procuring the creation of new shares by the corporation and their issuance to D for resale, a whole new set of problems would arise. Aside from the frustration of D's plans, which might result from a request for shareholder approval of an increase in authorized capital, existing shareholders might have a common-law, statutory or charter pre-emptive right which would be violated by an issuance of shares solely to D.

13. Whether a contract for the sale of controlling shares will be enforceable between buyer and seller presents its own problems. See note 181 infra.

14. Cases A and B involve Buyer's efforts to acquire 100% of the corporation's outstanding shares. If Buyer makes an offer to purchase D's shares, as well as some but not all of the remaining outstanding shares, he may acquire effective control of the enterprise without 100% ownership. The writer believes that a selling shareholder whose shares enter into a block of shares which Buyer eventually acquires should be accorded the same rights as are given to selling shareholders when Buyer acquires all of the corporation's shares. It is the writer's thesis that the sale of the control of an enterprise is a unique transaction which cannot be equated merely with a sale of shares and that the opportunity to participate proportionately in the proceeds of that transaction should be made available to all those whose shares make up the controlling block which Buyer acquires. Nor should the rights of such selling shareholders be diminished by a showing that D's shares alone were sufficient to give Buyer control; if Buyer desired to make that control more complete and less subject to interference by acquiring shares in addition to D's, the selling shareholders contributing to that more complete control should have the benefits of their contribution. The remedies of remaining shareholders whose shares Buyer did not purchase are considered in Part Two at pp. 774-835 infra. Whether selling shareholders should have a remedy in every case in which a manager or controlling shareholder purchases for resale to someone not acquiring control poses different problems and is not the subject of examination in this article.
the benefit of that opportunity is enjoyed by only one segment of the whole corporate family. It might reasonably be asked whether, as a matter of wise administration of the corporation as the major form of business organization, managers and controlling shareholders should be permitted to appropriate such opportunities. Selling shareholders might have taken the position that there is a community of interest in the enterprise as a whole, shared by all of the shareholders, which overrides the division of the corporation into separate units and that such a community of interest requires recognition when the control of the enterprise is sold and their shares have entered into that sale. They might have urged the development of rules of law specifically directed toward molding the corporation as an institution and designed to effect as nearly as possible a proportionate distribution, among all shareholders whose shares enter into a control transaction, of the total consideration paid by one who is purchasing control. The writer believes that such rules are being developed and that they should be adopted and applied by the courts.

Selling shareholders have rarely taken that position squarely before the courts. Whether the courts are consciously deciding cases with an appreciation of that position is not frequently revealed in their opinions. The obstacle to judicial examination of the questions which it raises has been that a share transaction may more easily be viewed as a mere purchase and sale of a species of property than as a matter of corporate engineering. As such, a more customary set of rules seems to be applicable, rules relating to an entirely different institution: counsel for selling shareholders most frequently complain of D's conduct in Cases A and B on the ground that he committed a "fraud" on their clients in connection with a purchase or sale of property and even then rarely urge specific examination of the incidents of that property in the light of the corporate institution of which it is an element. And although the corporate issues necessarily underlie such cases and may at times enter into the courts' determinations, they are for the most part obscured, and possibly obliterated, by the inquiry into whether the selling shareholder has been "misled" by D's behavior. Selling shareholders may bring the question into issue in an action at law for fraud and deceit, or a suit in equity for rescission or for a money decree to redress a "fraud" or to require a "fiduciary" to account. The case in which they are most likely to succeed arises when they allege that D acquired their shares for resale or induced them to sell to Buyer by means of misrepresentation. It may be asked whether the results of such cases shed any light on the underlying corporate issues.
1. Misrepresentation

The “elements” of a cause of action at common law for fraud and deceit form the major external guide posts for judicial decision in cases involving the misleading of sellers of corporate securities. The usual questions asked are: (1) Did the defendant make a false statement? (2) Was it a statement of fact? (3) Was the fact material? (4) Did the defendant know or have reason to know it was false? (5) Did the defendant intend to induce the selling shareholder to act in reliance on the statement? (6) Did the selling shareholder reasonably rely on the defendant’s statement? (7) Did the selling shareholder suffer loss? If the issue is raised in an equity court, the court may be less concerned with the defendant’s knowledge of the falsity of the statement, but in the cases examined in this article there is hardly a question on that score.

Emphasis is placed for the most part on the satisfaction of the “elements” of the cause of action for fraud. Judicial attention thus is diverted from the issue whether a manager or controlling shareholder should be entitled to retain the benefit of his transaction when he has purchased for resale or has acted as intermediary for Buyer’s acquisition of shares. The circumstances under which D acted are of major importance. And those circumstances may vary widely, as has been demonstrated in the many cases involving share trading not necessarily engaged in as part of a scheme to transfer control. D may tell a lie about any number of matters in order to induce other shareholders to part with their shares. He may tell them that business is bad, earnings have fallen, assets have depreciated badly or are obsolete, or the corporation will not soon be able to pay a dividend. Or he may assert that the shares he is buying are “worth” no more than the amount he is offering for them. Detailed analysis of those cases will not be made here, since the intended focus is on purchases involving a third party’s acquisition of control, and the making of such false state-
ments is not a peculiar incident of those transactions. But it may be suggested that the shifting and uncertain content of the "elements" of the fraud action make liability less than inevitable even in cases involving an outright lie. For example, it has been asserted that a statement by a buyer respecting the "value" of purchased shares is not a statement of "fact"; that a statement about the internal financial condition of the corporation may not reasonably be "relied" upon by one who is a shareholder and can look at the books himself; that an admittedly false statement may not be "material." Such results are not invariable; in some courts liability under such circumstances has been found. But the diversity of result makes it difficult to generalize about "underlying" policy determinations which the courts may be making and emphasizes the necessity for close examination of those determinations. Consider the court which holds that a selling shareholder has failed to prove one of the "elements" of his cause of action and that he cannot recover from a manager or controlling shareholder as a result. It might be asserted that such a court is really making a judgment about the corporate institution: i.e., it is desirable to afford immunity to corporate managers and controlling shareholders in connection with their share trading (and it is appropriate for a court to use any reasonable and intellectually honest means to produce that immunity). Other observers might assert in contradiction that in such a case no judgment about the corporate institution is being made at all; the court is merely convinced that selling shareholders' claims are like those of any other seller of personal property, that such shareholders have a cause of action if they have been misled and that the facts of the case do not demonstrate that that has occurred. More probably, both ideas play a part in any particular case, and it is difficult to say whether a judge has been influenced more by one of them than by the other.

Recognizing, then, that the bases for decision even in cases involving alleged misrepresentation are ambivalent and that it is difficult to describe a particular case as clearly representing a pronouncement.

19. The problems encountered in applying common-law fraud doctrines to securities transactions are discussed in Shulman, Civil Liability and the Securities Act, 43 Yale L.J. 227 (1933).
22. See cases cited in note 20 supra.
ment on "corporate policy" or on the law of "misleading conduct," the control transfer cases may be examined with the interplay of those ideas in mind.

Consider hypothetical Case A, in which the manager or controlling shareholder purchases for a resale which will give Buyer control. The cases in which the manager or controlling shareholder has used false representations to induce a sale to him in anticipation of resale are rare. When the cases have arisen, liability has been found when the manager or controlling shareholder has lied about values, earnings and other internal matters.23 Such lies had the purpose and effect of misleading the shareholder into selling at a price lower than was justified by the value of assets or the earning power of the corporation. Therefore the fact that the insider had a resale contract was not clearly relevant and did not enter into determining whether the false representation was of a "material" fact. On the other hand, the relevance (and the "materiality") of such a resale contract may be demonstrated by the case of the selling shareholder who recovers from a manager who has told a lie solely for the purpose of concealing the manager's profitable opportunity to resell.24 Although it may be argued that the court is merely affirming the right of an individual shareholder to make up his own mind about selling to someone who will make a personal profit from his shares, the result suggests judicial recognition of the proposition that a shareholder has a protectable interest in the sale of the enterprise as a whole even though it is cast in the form of a sale of shares.

In hypothetical Case B, a factual variant of the straight purchase and resale case, fraud doctrines have again been applied by the courts.

23. McMynn v. Peterson, 186 Wis. 442, 201 N.W. 272 (1924). (Action was brought for rescission by a selling shareholder. Defendant was an officer, director and majority shareholder. He entered into a tentative agreement with the buyer to sell all the corporation's outstanding shares at book value of over $27 per share. Keeping the pending sale secret, defendant's associates acquired plaintiff's shares for $15 per share and completed the sale to the buyer. A false financial statement had been exhibited to plaintiff, and other false representations about the state of the corporation's business had been made. Plaintiff was awarded the difference between the price paid him for his shares and the price defendant received for them from the buyer.) See also Blazer v. Black, 196 F.2d 139 (10th Cir. 1952).

24. In Schroeder v. Carroll, 192 Wis. 460, 212 N.W. 299 (1927), a selling shareholder, owning 37½ shares out of 1055 shares outstanding, asked the defendant (who was secretary and manager of the corporation, as well as the owner of 255 shares) if there was "anything in sight where the stockholders will receive a benefit in any way, shape or manner. . . ." Id. at 461, 212 N.W. at 300. The defendant replied: "There is absolutely nothing," (id. at 462, 212 N.W. at 300) although he knew that there was pending a sale of all of the corporation's shares at a proposed price of $145 per share. The selling shareholder sold his shares to the defendant for $93 per share, and the latter resold them at $143 a share. The court upheld a jury verdict awarding the selling shareholder damages measured by the difference between $93 and $143, the jury having found the latter figure to be the "value" of plaintiff's shares. Cf. Voellmeck v. Harding, 166 Wash. 93, 6 P.2d 373 (1931).
In such a case the manager or controlling shareholder may sell his own shares and at the same time either (1) advise the other shareholders to sell to the same third party or (2) act ostensibly on their behalf to bring about a sale to the third party. The selling shareholders know that Buyer is acquiring control; they do not know how much he is paying for the whole enterprise. As a result of the transaction, the manager or controlling shareholder may receive a higher price for his shares than other shareholders receive, or he may receive the same "price" as other shareholders receive plus a "bonus." In either event, the cash return to the manager or controlling shareholder, per share of stock owned by him prior to the transaction, is higher than the cash return per share to the other selling shareholders. If the selling shareholders part with their shares on the basis of a false representation, legal doctrine is available to support a recovery from the manager or controlling shareholder who makes the representation. This is so even though the selling shareholder sells directly to the third party purchaser of control rather than to a manager or controlling shareholder who in turn resells.

Again, as in the discussion of hypothetical Case A, the question arises whether the courts are grounding liability on some conception of corporate policy or relying seriously on the traditional doctrines of misleading behavior. In the cases presently under consideration, although the making of false representations has almost invariably resulted in liability, the courts have imported other doctrines to achieve the result. One court, holding a manager liable to selling shareholders for lying to them about the price at which a third party was buying all the shares, stated that it made no difference whether the defendant's obligation to tell the truth arose from doctrines of "confidential relations," "agency" or "fraud." In one classic case, the court em-

---


26. Stanton v. Hampton, 272 Fed. 424, 432 (9th Cir. 1921); see also Stanton v. Hamilton, 272 Fed. 432 (9th Cir. 1921); Upton v. Southern Produce Co., 147 Va. 937, 133 S.E. 576 (1926).

27. Sautter v. Fulmer, 258 N.Y. 107, 179 N.E. 310 (1932), modification aff'd, 262 N.Y. 700, 188 N.E. 127 (1933). The plaintiffs, holders of a minority of the corporation's shares, alleged that defendant Fulmer "dominated" the corporation and the negotiations leading up to the sale of shares. Fulmer owned or controlled a majority of the corporation's shares. He informed plaintiffs that an offer had been made for $300 a share, paid that amount to plaintiffs and delivered their shares to the buyer for the same price. (Although in the court's language defendant "purchased" plaintiffs' shares, it appears that the transaction was a "purchase" only in form, since defendant had "purchased" the shares from plaintiffs with a clear understanding that the shares were to be delivered to the buyer for the same amount paid to plaintiffs by defendant.) Shortly after the defendant's delivery of plaintiffs' shares to the buyer, defendant delivered the remaining (majority) shares to the buyer for $1,098
phasized the “fiduciary position” of the defendant (an officer, director and majority shareholder) in holding him liable to account to selling shareholders to whom he had lied about the price of an offer for all of the corporation’s shares. Other courts have approached such a case on a theory of agency, a theory not difficult to support factually since the selling shareholder knows that the manager or controlling shareholder is interposed between himself and the third party.

One may only cautiously glean from the cases emphasizing false representation, on the facts of Case B, that the courts are trying to solve the problem from some standpoint of corporate policy. The choice of doctrines more subtle than those usually associated with the common-law action for fraud and deceit may merely have resulted from an attempt on the part of counsel or court to lend more plausibility to an argument that the selling shareholder has been misled. The classical elements of the fraud action include a factor of “reliance”; a court may find that a manager or controlling shareholder was an “agent” or “fiduciary” for a selling shareholder only because such a finding seems to justify the selling shareholder’s reliance on lies made to him. Or a selling shareholder may merely be trying to bring his case into equity to obtain a more effective remedy than he would have under common-law rules of damages. An allegation of “fraud”

a share. Defendant was required to account to plaintiffs, in proportion to their holdings, for the total amount received from the buyer for all the shares. Cf. Falk v. Hoffman, 233 N.Y. 199, 135 N.E. 243 (1922) (in equity for rescission and accounting; demurrer overruled); Falk v. Hoffman, 241 N.Y. 569, 150 N.E. 558 (1925) (affirming dismissal of complaint at trial).

28. The supreme court at special term found as a fact that Fulmer was the president, treasurer and general manager of the corporation. Decision of Trial Judge, Transcript of Record for Case on Appeal, p. 40.

29. Although the court’s mention of the fact that the defendant had kept secret the difference in the arrangements for the sale of the two blocks of shares points in the direction of liability based upon nondisclosure, the case does not represent a strong precedent on that issue. There was evidence of defendant’s false representation. It is coincidental that every false representation carries with it some element of nondisclosure. Cf. McMynn v. Peterson, 186 Wis. 442, 201 N.W. 272 (1924), in which the manager (1) falsely stated the book value of shares he was purchasing and (2) failed to disclose a profitable proposed resale. It might be questioned whether the nondisclosure of the resale increased the likelihood of defendant’s liability in the McMynn case, in view of the independent false statement by which he procured the shares at a reduced price.

30. Reed v. Pitkin, 231 Mich. 621, 204 N.W. 750 (1925); Barber v. Martin, 67 Neb. 445, 93 N.W. 722 (1903). See also Mulvane v. O’Brien, 58 Kan. 463, 49 Pac. 607 (1897). (Defendant procured shares of selling shareholders with understanding he would find a purchaser; defendant made false representations about the buyer’s inspection of plant to conceal the buyer’s interest from shareholders; accounting ordered on theory of agency.) Cf. Wann v. Scullin, 210 Mo. 429, 109 S.W. 688 (1908).

31. Prosser, TORTS 523, 550 (2d ed. 1955); 3 Restatement, TORTS §§ 525, 537 (1938).

32. Falk v. Hoffman, 233 N.Y. 199, 135 N.E. 243 (1922). Under the common law, a selling shareholder is entitled to recover the difference between the price he has received for his shares and their “value.” 3 Restatement, TORTS § 549 (1938);
alone might or might not persuade the equity court to take jurisdiction; the allegation of an independent equitable ground might be more successful. Such an independent ground may be found in one of the many outgrowths of equity's jurisdiction over the express trust; if the defendant can plausibly be described as a "fiduciary" and the description documented by facts showing that the selling shareholder reposed "trust" in him in the particular case, the equity court may open its doors. If the courts are doing no more than putting a gloss on traditional doctrines of misleading conduct, they have not given much enlightenment on corporate policies which may underlie their decisions.

It does appear that something more is being done, something which sheds light on the proposition that shareholders have a community of interest in control sales. The conflict in the cases suggests that what is being done is important. In some courts, the selling shareholder has been awarded recovery from the manager or controlling shareholder in the form of a judgment or decree effecting a proportionate sharing of the total amount paid by the buyer to acquire the enterprise.

33. "Misrepresentation was recognized very early as a basis for the jurisdiction of courts of equity, at a time when the existing forms of action at law were inadequate to deal with the injustices which resulted. When the law courts later developed remedies for such cases, the equity courts refused to surrender their jurisdiction, saying that the nature of the 'fraud' made it peculiarly a matter for their interference." PROSSER, TORTS 524 (2d ed. 1955). There is, however, the possibility that an equity court will surrender that jurisdiction on the basis of the adequacy of the legal remedy, particularly when the plaintiff seeks monetary relief and does not seek the peculiar aid which equity courts afford by way of injunction, discovery, accounting and the like. See 3 POMEROY, EQUITY JURISPRUDENCE § 914 (5th ed. 1941).

34. See 4 POMEROY, EQUITY JURISPRUDENCE §§ 1088, 1089 (5th ed. 1941).


36. Stanton v. Hample, 272 Fed. 424 (9th Cir. 1921) (at law); Reed v. Pitkin, 231 Mich. 621, 204 N.W. 750 (1925) (in equity); Barber v. Martin, 67 Neb. 445, 93 N.W. 722 (1903) (at law); Sautter v. Fulmer, 258 N.Y. 107, 179 N.E. 310 (1932) (in equity); Schroeder v. Carroll, 192 Wis. 460, 212 N.W. 299 (1927) (at law);
ager or controlling shareholder has sought to justify his retention of a larger share by pointing to his assumption of additional obligations not required of the other selling shareholders, such as covenants not to compete, guarantees of collection of accounts, assumption of contingent liabilities and the like. Therefore, to some courts at least, so strong is the policy in favor of proportionate sharing of the fruits of a sale of the enterprise through a sale of shares that the benefits flowing from the assumption of such obligations cannot be retained unless the opportunity to join in their assumption is laid open to other shareholders. In spite of such holdings, the presence of falsehood, such an easily recognized ground of liability, simply tends to obscure other issues.

But not all commercial transactions take place in an atmosphere of prolix conversation involving a risk of false talk. Cases A and B may as easily involve a manager or controlling shareholder who is inclined to abstain from talking about his reasons for purchasing shares or advising other shareholders to sell. The cases demonstrate that defend-

---

1. Voellmeck v. Harding, 166 Wash. 93, 6 P.2d 373 (1931) (at law). In the cited cases defendants were either managers or, as in the Sautter case, controlling shareholders who were also managers. The Sautter case is significant because of the fact that the court did not ground the defendant's liability in his occupation of a managerial position as distinguished from his control of majority shares.

37. In Sautter v. Fulmer, 258 N.Y. 107, 179 N.E. 310 (1932), the defendant's additional obligations included certain indemnifications (from libel suits growing out of any act committed by the corporation during the time it was under defendant's control, against claims not appearing on its books and records and from specified additional tax assessments), a covenant to abstain for ten years from engaging in the newspaper business in New York State, acceptance of the purchasers' bonds instead of their note and a warranty as to the truth of financial statements. The court noted that it could not say, as a matter of law, that the covenants had no value, but it gave two reasons for denying recognition to that value: (1) the value attributable to the covenants was too vague and shadowy, and the process of disentangling any such value from the remainder of the consideration would be too complicated and artificial to be practical; and (2) even if the value could be determined, the defendant would not be permitted to reduce his obligations to the plaintiffs by that amount because he had misstated facts and had kept secret a personal benefit emanating from the additional obligations. In Stanton v. Hamble, 272 Fed. 424 (9th Cir. 1921), the defendant was required to account although he claimed that he had received more for his shares than the selling shareholders had received because of a covenant not to compete for ten years, a guaranty of collection of accounts receivable and a promise to assist the buyer for one year. In Barber v. Martin, 67 Neb. 445, 93 N.W. 722 (1903), the court rejected the defense that the excess price paid to defendant covered defendant's covenant not to compete.

38. Contra, Walsh v. Goulden, 130 Mich. 531, 90 N.W. 406 (1902) (agreement by directors to remain in employ of corporation); Terry v. Green, 185 App. Div. 517, 173 N.Y. Supp. 309 (1st Dep't 1918) (covenant not to compete); Klerlein v. Werner, 307 Pa. 16, 160 Atl. 719 (1932) (indemnification of purchaser against claims on corporation and covenant to withdraw from rug and carpet business for a period of years; questioned transaction involved purchase of shares in contemplation of sale of all assets). The courts which permit a defendant's retention of excessive price appear either to have ignored the difficult problem of placing a value on such special agreements and comparing that value with the excess amount received by the defendant or else to have assumed that the burden of proof on that issue lay with the complaining shareholder. See Klerlein v. Werner, supra at 22, 160 Atl. at 720, and text at pp. 792-93 infra.
The ant's conduct, by ever changing degrees, may pass from the fulsome lie through the half truth to the complete nondisclosure of facts which might reasonably be thought material. Attention is directed in the following subdivision toward the cases which do not involve primarily the making of blatant falsehoods.

2. Nondisclosure

Hypothetical Cases A and B may be examined, therefore, from the point of view of the manager or controlling shareholder who does not disclose, in one case, a profitable resale contract or, in the other, the price which the purchaser of control is paying for the total enterprise. Consider Case A, the case of the manager or controlling shareholder who sells his own shares and simultaneously purchases other shares which he resells at a high price without disclosing his purpose in buying the shares. The manager or controlling shareholder may try to avoid liability to the selling shareholder by asserting that the shareholder has suffered no loss. His argument may be that Buyer would not have entered into the transaction if he had had to negotiate with a number of shareholders and that the selling shareholder has thus not proved he could have made the same profitable sale if Buyer's desires had been disclosed to him.

Some courts have accepted this argument. However, the fact that the selling shareholder has not proved he has lost an assured sale has not precluded recovery when false representations have been shown. In addition, the courts have considered cases in which a manager has purchased outstanding shares with a view to acquiring complete ownership of a corporation prior to a sale of all of the assets; selling shareholders have recovered their proportionate share of the proceeds of a sale of the assets without being required to prove that the purchaser of the assets would have gone through with the transaction whether or not the corporation had one or many shareholders. If the manager or controlling shareholder has purchased all outstanding shares in anticipation of either a sale of all the shares or a sale of all of the assets, it may be an open question in either case whether the ultimate buyer would have entered into the transaction if

40. Schroeder v. Carroll, 192 Wis. 460, 212 N.W. 299 (1927).
he had had to deal with a number of shareholders rather than merely
one. But in a case involving a resale of shares, the selling shareholder
has suffered at least the loss of an opportunity to bargain. Buyer was
interested in buying complete control, and the plaintiff’s shares were
apparently useful to him to that end. It is true that the value of that
lost opportunity to bargain may be difficult to measure, but that can
hardly be attributable to the selling shareholder. It is the manager
or controlling shareholder who has foreclosed that opportunity and
has made it impossible for the selling shareholder to prove its value.
It should therefore not be necessary for the selling shareholder to resort
to independent proof of the value of that opportunity. In the absence
of other evidence, the most objective standard is already at hand: the
total amount which Buyer paid for all the shares. To award the selling
shareholder a proportionate part of that amount would serve as a rough
approximation of the value of his opportunity. It can be only an
approximation, since it is impossible to prove that Buyer would have
paid the selling shareholder more or less than that proportionate part
if separate bargains had been necessary. Legal theory has not been
found lacking to permit recovery of that proportionate part despite
the impossibility of proving the extent of loss with measurable ac-
curacy.42

That the selling shareholder has suffered a disadvantage which
the courts can handle is clear. The next question is whether they are
willing to protect him from such disadvantages by imposing on man-
gers and controlling shareholders even that minimum obligation of
sharing their gains from transactions in his shares. The question
of the responsibility of the manager or controlling shareholder may be
phrased in terms of “duty,” i.e., does he have a duty to disclose his
resale contract in Case A or his personal profit in Case B? 43 In the
main, courts have had a generalized bias which protects nondisclosures
in ordinary commercial transactions. The hypothesis appears to be

42. In equity: Falk v. Hoffman, 233 N.Y. 199, 135 N.E. 243 (1922) (equity will
charge defendants with “trust” of proceeds from resale of plaintiff’s shares); Upton v.
Southern Produce Co., 147 Va. 957, 133 S.E. 576 (1926) (equity will grant recovery
of “secret profits” procured by fraud and misrepresentation and breach of fiduciary
duties).

At law: Staker v. Reese, 82 W. Va. 764, 97 S.E. 641 (1918) (plaintiff entitled
to recover difference between amount defendant paid plaintiff for shares and amount
defendant received for them from subsequent sale of assets; even if defendant entitled
to charge that plaintiff’s damages are measured by “market value” of stock, best
evidence of market value is selling price); Schroeder v. Carroll, 192 Wis. 460, 212
N.W. 299 (1927) (with other evidence, amount received by defendant from resale is

43. See 3 RESTATEMENT, TORTS § 551 (1938); RESTATEMENT, CONTRACTS § 472
(1932).
that normally in a transaction of purchase and sale the parties deal at arm's length and that, in the arm's length transaction, neither party has a duty to disclose facts concerning the subject matter of the sale.\footnote{Bowen, Actionable Non-Disclosure §§163-68 (1915). A modern application of the hypothesis is Swinton v. Whitinsville Savings Bank, 311 Mass. 677, 42 N.E.2d 808 (1942). (Action by purchaser of dwelling house was based solely on seller's failure to disclose the presence of termites. In awarding judgment for seller the court stated: "The law has not yet, we believe, reached the point of imposing upon the frailties of human nature a standard so idealistic as this." Id. at 678-79, 42 N.E.2d at 809.) But see Annot., 141 A.L.R. 967 (1942).}

It may be suggested that the vitality of the doctrine which accords immunity from such liability is a reflection of the general conviction that there is less moral opprobrium attached to keeping silent than to telling a lie. But it is only in part grounded in that conviction. Far more significant, the doctrine appears to be retained because it fits into and helps to maintain the existing pattern of behavior in a competitive economy. Such an economy encourages habits of nondisclosure, particularly where market conditions are concerned. The corner grocer is not required to announce to the housewife that his eggs are priced two cents higher than those of the grocer one block down the street. Nor is the purchaser of a dwelling house required to disclose that he is already negotiating for its profitable resale to a third party, even though the owner of the house has suffered a loss, in the sense that he might be in a better position if the disclosure were made and he were given an opportunity to bargain.\footnote{See Lucas v. Long, 125 Md. 420, 94 Atl. 12 (1915), and comments thereon in Morris, Torts 268 (1953); Keaton, Fraud—Concealment and Non-Disclosure, 15 Texas L. Rev. 1, 21 (1936).} On the whole it is thought to be economically desirable to reward the diligent who have acquired a superior market position. Should that rule of non-liability be extended to the manager or controlling shareholder in Cases A and B who profits from the market which he has for the shares of other shareholders? Counsel for selling shareholders have suggested that the rules should not apply; the reasons they have given have not produced consistent results.

Counsel might have argued that the peculiar facts of corporate life were sufficient grounds for imposing liability upon managers and controlling shareholders gaining from control transactions, requiring that a transfer of the entity as a whole, whether by way of a merger, sale of all of the assets or sale of all of the shares, shall inure to the benefit of all shareholders. Instead, they quite naturally looked for a useful analogy in prior cases and found one in the "fiduciary relationship." The effort was made to bring to bear rules developed in cases involving principal and agent, guardian and ward, lawyer
and client, trustee and beneficiary, director and the corporate entity.\(^{46}\)
The vast bulk of litigation by selling shareholders has been directed
toward enforcing accountability by directors and officers. So far
as legal doctrine is concerned, judicial reaction to the pressing of the
analogy of the "fiduciary relationship" in that litigation has divided
three ways:

(1) In one line of cases, frequently said to represent the majority
rule, the courts have observed that: (a) a director or officer is a
"fiduciary" to the corporate entity only and not to the shareholders,
and (b) the ambit of the duty owed by a director or officer as fiduciary
extends to "corporate acts" only and not to share trading.\(^{47}\)

(2) In another line of cases, representing the so-called minority
rule, the courts have held that: (a) a director or officer is a "fiduciary"
to the corporation, to be sure, but also, through the corporation, a
fiduciary to the whole body of shareholders and thus to each of the
shareholders, and (b) the duty owed by such a fiduciary extends not
only to "corporate acts" but also to share trading.\(^{48}\)

(3) In the middle ground following the "special facts" or "special
circumstances" rule laid down by the Supreme Court in Strong v. Repide,\(^{49}\)is a line of cases holding that an officer or director is a "fidu-

46. See 1 Scott, Trusts § 2.5 (1939), for a description of the "fiduciary relationship."
47. Board of Commissioners v. Reynolds, 44 Ind. 509 (1873); Crowell v. Jackson,
53 N.J.L. 656, 23 Atl. 426 (Ct. Err. & App. 1891); Carpenter v. Danforth, 52 Barb.
581 (N.Y. 1868); see also Geller v. Transamerica Corp., 53 F. Supp. 625 (D. Del.
1943); Waller v. Hodge, 214 Ky. 705, 713-14, 283 S.W. 1047, 1050 (1926); Gladstone
Minn. 170, 174-75, 188 N.W. 266, 268 (1922); Gardner v. Baldi, 24 N.J. Super. 228,
234, 93 A.2d 644, 647 (Ch. 1952).
48. Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903) (in equity for rescission
of sale of shares to a manager; plaintiffs contended that defendant had failed to disclose
that a profitable sale of the corporation's assets was being negotiated when defendant
renewed an option to purchase plaintiffs' shares). See American Trust Co. v.
California Western States Life Ins. Co., 15 Cal. 2d 42, 56-58, 98 P.2d 497, 504-05
(1940), for a discussion of the so-called majority and minority rules with respect to
the fiduciary duty of directors to shareholders of the corporation.
49. 213 U.S. 419 (1909). Defendant was a director, "administrator general" and
majority shareholder of a corporation whose only valuable assets were certain lands.
For some time defendant had been carrying on negotiations with the Philippine Gov-
ernment for the sale of those lands. At a time when there was a strong likelihood
that the corporation would conclude a very favorable sale of the lands, defendant
purchased plaintiff's shares for one-tenth of the amount they became worth when
the lands were subsequently sold. The purchase was made through an agent of de-
fendant, and neither the identity of the principal nor the state of the negotiations for
the sale of the lands was disclosed to the plaintiff. Plaintiff recovered, in the alterna-
tive, damages or her shares. The court stated: "If it were conceded, for the purpose
of the argument, that the ordinary relations between directors and shareholders in a
business corporation are not of such a fiduciary nature as to make it the duty of a
director to disclose to a shareholder the general knowledge which he may possess
regarding the value of the shares of the company before he purchases any from a
shareholder, yet there are cases where, by reason of the special facts, such duty
exists." Id. at 431.
"fiduciary" to an individual shareholder only when the relationship is created by particular events.°

These disparate rules have entered into the judicial handling of Cases A and B. Selling shareholders have taken the position that, despite the arm's length presumption in the ordinary case of buyer and seller, when a manager is buying for resale, as in Case A, he has a duty to disclose that fact solely because of his office. The argument is that the duty to disclose arises from the defendant's occupation of a fiduciary position toward the selling shareholder. And in Case B, even though he is not personally purchasing for resale, the same fiduciary position requires disclosure of his personal profit or a personal bonus.

If proponents of defendant's duty to disclose material facts to the selling shareholder had defined that duty in its own terms, i.e., solely as a "duty to disclose," judicial analysis might more clearly have been

50. "Special facts" cases are examined in Smith, Purchase of Shares of a Corporation by a Director From a Shareholder, 19 Mich. L. Rev. 698 (1921). See generally on the problem of managerial share trading: Berle, Publicity of Accounts and Directors' Purchases of Stock, 25 Mich. L. Rev. 827 (1927); Walker, The Duty of Disclosure by a Director Purchasing Stock From His Stockholders, 32 Yale L.J. 637 (1923); Laylin, The Duty of a Director Purchasing Shares of Stock, 27 Yale L.J. 731 (1918); Wilgus, Purchase of Shares of a Corporation by a Director From a Shareholder, 8 Mich. L. Rev. 267 (1910); Stevens, Corporations § 150 (2d ed. 1949); Ballantine, Corporations § 80 (rev. ed. 1946). Cases are collected in Annot., 84 A.L.R. 615 (1933).

51. Managers (who in some instances were also controlling shareholders), were held liable, on facts analogous to Cases A and B, in Dunnett v. Arn, 71 F.2d 912 (10th Cir. 1934); Dutton v. Barnes, 162 Minn. 430, 203 N.W. 414 (1925); Jacquith v. Mason, 99 Neb. 509, 156 N.W. 1041 (1916). Recovery was denied in Ryder v. Bamberger, 172 Cal. 791, 158 Pac. 753 (1916); Stout v. Cunningham, 33 Idaho 464, 196 Pac. 208 (1921); Haverland v. Lane, 89 Wash. 557, 154 Pac. 1118 (1916). The denial of recovery in Hayes v. Kelley, 112 F.2d 897 (9th Cir. 1940), and Blabon v. Hay, 269 Mass. 401, 169 N.E. 268 (1929), may be attributable as much to the fact that the resale occurred at a later time (and was not in contemplation at the time the defendant purchased from the plaintiff) as to a basic assumption that managers do not have a duty of disclosure.

As yet, the decided cases have not squarely presented the question of the liability, on the facts of Cases A and B, of the nondisclosing controlling shareholder who does not simultaneously occupy a managerial position. But nondisclosures other than those involved in Cases A and B may be in issue. In such a context, it was stated that if an officer or director does not stand in the "position of a fiduciary" to shareholders from whom he purchases, then, a fortiori, a majority shareholder does not occupy that position. Geller v. Transamerica Corp., 53 F. Supp. 625 (D. Del. 1943), aff'd per curiam, 151 F.2d 534 (3d Cir. 1945). However, in Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del.), as supplemented, 100 F. Supp. 461 (D. Del. 1951), motion for leave to file answer to common-law count denied, 103 F. Supp. 47 (D. Del. 1952), the court held that an action for fraud and deceit under the common law had been stated against a controlling shareholder, not occupying an office or directorship, who had purchased shares without disclosure of the increased value of inventory underlying the purchased shares and without disclosure of the defendant's intent to capture such increased value by merger, liquidation or dissolution. The Speed case is discussed at p. 770 infra in connection with § 10(b) of the Exchange Act. See also Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947), and note 126 infra. The difficulties encountered by the courts in finding a "fiduciary duty" applicable to controlling shareholders as such and the policies relevant to finding such a duty vis a vis selling shareholders are discussed in the next subdivision of this article, beginning at p. 750.
directed toward determining whether there is a compelling factual basis for such a duty. Categorization of the "duty to disclose" as a "fiduciary duty" has created confusion. Such a description of the duty carries with it the implication that it rests only on one who stands in a "fiduciary relationship" with another. But neither the courts nor the commentators have been able to demonstrate with any clarity whether the "fiduciary relationship" is a concept of law consonant with a duty to disclose or is a shorthand statement for a congeries of facts. 62

For example, the selling shareholder who argues that the defendant in Cases A and B has a duty to disclose his resale contract or personal profit may phrase his argument in terms of defendant's fiduciary relationship to him. It is unclear whether he is asserting that: (1) as a matter of law, the court should assume to impose the duty of disclosure on the defendant because of desirable corporate policy, or (2) as a matter wholly of fact, the arm's length presumption does not hold in the particular case. If a court applies the so-called majority rule to the selling shareholder's argument by saying that there is no fiduciary relationship and thus no fiduciary duty, it may be making only a legal pronouncement: it is not desirable to put the burden of disclosure on the manager or controlling shareholder. In so saying, the court may reject analogies to other so-called fiduciary relationships, such as that which obtains between trustee and beneficiary or corporation director and the corporate entity, even though in cases involving those other relationships it is applying rules of law for the purpose of shaping and preserving particular institutions serving peculiar functions in society or the economy and is not simply giving effect to the factual expectations of individual people. 63 If the court's approach to the problem of

52. E.g., the fact that one party to the relationship reposed trust and confidence in the other or reasonably expected that the "fiduciary" would look after his interests.

53. If the beneficiary of an express trust seeks an accounting from a trustee who has personally profited by a sale of property to the trust, it is not a requisite of the action that he show that he personally reposed any confidence whatever in the trustee; if he had any confidence at all, it might as reasonably have arisen from an unfounded idea that the courts would protect him. If it be argued that it is the settlor of an express trust who reposes such confidence, one may ask whether the settlor of a testamentary trust has factual confidence in a substitute trustee appointed after his death.

The director of a corporation is said to be in a "fiduciary relationship" to the "corporation." Again the question may be asked whether his obligations to account for personal profits from transactions in "corporate" property rest on factual expectations based on confidence that he will not seek such profits. The "corporation" as such clearly never had such factual expectations. If the people behind the corporate entity are examined, perhaps the majority shareholders who put him into office had such confidence. Possibly the minority shareholders who voted for some other candidate had no trust in him whatever. But it is totally irrelevant in an action by the "corporation" representing such diverse viewpoints of the director's honesty that even all of the shareholders at the time of his election had serious doubts about the extent to which he could be trusted; the director's liability has never been reduced in proportion to the number of shareholders shown to have had no confidence in him. Cf. Rohrlich & Rohrlich, Psychological Foundations for the Fiduciary Concept in Corporation Law, 38 Colum. L. Rev. 432, 448 (1938).
fiduciary relationships is thus legally, rather than factually, oriented, it may be possible to dissuade it from an uncritical analysis which lumps together all cases of nondisclosure by corporate managers and controlling shareholders under a common legal rubric of "no fiduciary duty." It may be possible, that is, to argue that there is need for development of peculiar rules for the corporate institution where control transactions are involved, just as it has been necessary to develop peculiar rules for the institutions of "trusts" and "agency."

On the other hand, the court applying the majority rule may merely be saying that the duty to disclose is grounded in defendant’s misleading conduct, that it arises only when, as a factual matter, the selling shareholder reasonably expects that the whole truth is being made known to him. If the court thus equates the fiduciary relationship with selling shareholder’s reasonable factual expectations, it may be much too late to argue that the manager or controlling shareholder in Cases A and B occupies that relationship to the selling shareholder. Perhaps when the rule of "no fiduciary duty" was first laid down in the last century, it was true that shareholders were not particularly confident that corporate management or controlling shareholders would tell them the truth. But whether such shareholders did in fact expect disclosure is no longer of any moment. What is important is that a rule so long established, whether it is a rule of law or a generalized factual finding, becomes self validating as it becomes more known and pervasive. Today, in a jurisdiction where the majority rule has been applied with some consistency to relieve a nondisclosing corporate manager from liability, the selling shareholder will deal at arm’s length with his managers because the courts have told him he must. There may be no "fiduciary duty" simply because the factual basis for it does not exist.

54. Cf. Restatement, Contracts § 472 (1932). Although the Restatement holds open the possibility that there is no privilege of disclosure by a party who “. . . is denied immunity for non-disclosure by any special rules of law” (subsection d of § 472), it asserts also that the privilege is denied to one who “. . . occupies such a relation to the other party as to justify the latter in expecting that his interests will be cared for. . . .” (subsection c of § 472). Subsection c appears to have a factual, rather than legal, orientation. In comment c to § 472, in discussion of "justifiable expectation," reference is made to the "fiduciary position" as one of the relations referred to in the section.

3 Restatement, Torts § 551 (1938), on the other hand, is less clearly factually oriented. A duty of disclosure is imposed with respect to “. . . such matters as the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them . . .” (Subsection 2(a)). Although the relation of "trust and confidence" appears to require a factual basis (whatever the courts may say as to the matters one is entitled to know from a person in that factual relation) the Restatement eschews any discussion of the duties which "the directors of a company owe to its shareholders" (comment e to § 551), thereby leaving open the possibility of development of rules of law not dependent on factual trust and confidence.
The basis for the minority rule that there is a fiduciary relationship, and a corresponding fiduciary duty, may also have had either a factual grounding or a legal one. If the courts began with some notion that they properly should give shape to the corporate institution by adopting a rule of required behavior, selling shareholders may now as a fact expect managers to tell them the truth, especially if they are familiar with the law. In any event, their factual expectations are irrelevant, since the rules developed by the courts have made them so.

The "special facts" cases involving share transactions other than those in Cases A and B vacillate without clarity between factual and legal bases for a duty of disclosure. In some, liability depends not so much on nondisclosure as on the making of false representations. Cases in which a manager is held liable for failing to disclose his identity when purchasing shares suggest that the basis for the duty may be the fact that a selling shareholder may reasonably distrust, rather than trust, the managers of his corporation: had he known that a manager was purchasing his shares he would have become suspicious that some impending benefit was being privately appropriated. However, other "special facts" cases do not emphasize factual trust or distrust but appear to impose a duty of disclosure as a rule of law required by circumstances, such as an undisclosed contemplated sale of all of the corporation’s assets, under which the selling shareholder cannot adequately protect himself. The result is reached primarily on the basis of desirable corporate policy.

With respect specifically to Cases A and B, when nondisclosures have been alleged, recovery has been denied to selling shareholders by some courts and granted by others. When denied, the result has been put in part upon the rule of "no fiduciary duty," perhaps as a matter

---

58. In some of the cases in which managers or controlling shareholders have been held liable to selling shareholders in connection with share trading, the courts purport to see factual grounds for a finding that the plaintiff had reposed trust and confidence in the defendant and that his factual expectations were reasonable. However, those cases generally involve false representations as well as nondisclosure. Since the character of particular representations and their commercial reasonableness in the context in which they were made have a significant effect on the question of the reasonableness of the factual expectations of the persons to whom they were made, those cases do not furnish a reliable guide to cases in which no such representations appear. Cf. Hobart v. Hobart Estate Co., 26 Cal. 2d 412, 159 P.2d 958 (1945); Jaynes v. Jaynes, 98 Cal. App. 2d 447, 220 P.2d 598 (1950); Fox v. Cosgriff, 66 Idaho 371, 159 P.2d 224 (1945).
of law, perhaps consciously on the ground that there was no misleading on the facts. When granted, liability has not clearly been grounded on the disappointment of the shareholders' factual expectations. The court which awarded recovery to selling shareholders in a situation similar to Case B and justified its conclusion on the theory that the defendant had been engaged in a "joint undertaking or enterprise" with the selling shareholders and "heading a syndicate" to sell all the shares did not point to plaintiffs' factual expectations that their interests were being cared for. Equally consistent with that court's reasoning is the thought that, in such a situation, the law will impose an obligation on the manager or controlling shareholder to share with other shareholders the benefits of a sale of the enterprise. As a further example, the court in the leading case of Dunnett v. Arn resorted to elaborate legal doctrine to justify recovery from managers who sent a letter to shareholders informing them of an outside offer for their shares at a named price. Although the managers informed the selling shareholders that the managers' own shares had been sold, no revelation was made of the high price they had received. Selling shareholders recovered a proportionate part of the excessive price received by the managers. Not content with justifying the result solely on the basis of the defendants' misleading conduct, the court showed sensitivity to the proposition that all selling shareholders should share equally in a transfer of the enterprise even though it is effected by a sale of shares. The court observed that the transaction was "in substance" a sale of assets, that a sale of assets is a "corporate transaction" and that an officer and director occupies a fiduciary relation to shareholders with respect to corporate transactions (whatever the rule of fiduciary duty might be with respect to share trading). Such reasoning does not appear to base liability on factual trust and confidence reposed by the selling shareholders. It does not appear unreasonable to see in this opinion tentative probings in the direction of a rule of corporation law enforcing equality of treatment of all shareholders when a third party is acquiring firm control of the enterprise. Al-

59. See Ryder v. Bamberger, 172 Cal. 791, 158 Pac. 753 (1916); Stout v. Cunningham, 33 Idaho 464, 196 Pac. 208 (1921); Haverland v. Lane, 89 Wash. 557, 154 Pac. 1118 (1916).
62. "Men engaged broadly in business affairs generally would say that such a transaction should not succeed; and the view that it cannot is properly crystallized into a principle of law." Id. at 432-33, 203 N.W. at 415.
63. 71 F.2d 912 (10th Cir. 1934), 20 CORNELL L.Q. 101.
64. Those plaintiffs who had received the managers' letter, but did not prove reliance on the half-true statements in the letter, did not recover in this case or in a companion case growing out of the same transaction. Roby v. Dunnett, 88 F.2d 68 (10th
though the decided cases have involved either those who were solely managers or controlling shareholders who were also managers, the fact that some courts appear to be reaching for rules of conduct grounded on corporate policy rather than on individual expectations suggests that eventually, on the facts of Cases A and B, no distinction must necessarily be made between the liability of the manager or the manager-controlling shareholder on one hand and the controlling shareholder, as such, on the other.

If it be suggested that a rule of law which moves away from more conventional doctrines of fraud ignores the arm's length presumption of commercial trading, it is freely admitted that that is being proposed. The law has moved in that direction in other areas when social and economic needs have dictated it. Doctrines of nuisance, negligence and implied warranty have gradually been applied in increasing instances to break down the notion that arm's length trading is an immutable rule. The rules of responsibility applied to agents and trustees, or even to corporate directors with respect to transactions more conventionally recognized as "corporate," are not wholly explainable on a factual failure of the arm's length presumption. The law has molded those institutions to socially desirable ends. The obligation of the insured to disclose to the insurer the material facts known to the insured does not survive for any reason of trust and confidence between the parties, but surely because the business of insuring would operate at a higher cost to all insureds if the rule were not so.

Courts will not readily free themselves from analyzing the problems involved in sales of corporate control in terms of "fraud" and misleading conduct, however, so long as the manager or controlling shareholder enters so evidently into the transaction as he has in the

---

Cir.), cert. denied, 301 U.S. 706 (1937). Those results do not militate against the proposition that the Arn case moves in the direction of the establishment of a rule of corporation law requiring proportionate treatment of all shareholders whose shares enter into a control sale. If a selling shareholder knows that the managers or controlling shareholders are receiving a higher price from the buyer than he has received, he may reasonably be said to have waived his right to proportionate treatment. To that extent, there can be no argument with the court's denial of recovery to certain shareholders in the Arn and Roby cases. The writer believes, however, that the court should have imposed a burden on the defendants of proving that such a waiver had been made, i.e., of proving that they had disclosed the price which the defendants had received for their shares.

66. "When the principal employs an agent, the law presumes that he does so in order to secure to himself the benefits of the agent's skill, experience or discretion, and to reap the fruits of the performance of the undertaking. The law presumes that he expects—and it gives him the right to expect—that the agent so employed will endeavor to further the principal's interests, and will use his powers for the principal's benefit." MEchem, OUTLINES OF AGENCY § 500 (4th ed. 1952); see note 53 supra.
cases discussed heretofore. Judicial inclination to examine the question from the standpoint of the corporate institution is diverted by the availability of the more familiar concepts, which, as seen, may lead as easily away from managerial responsibility as toward it. When the manager or controlling shareholder has become conscious of the risks attendant upon his entering into the transaction as an active party and has bargained separately with the buyer for his own shares (leaving the buyer to his own devices in approaching, bargaining with and purchasing shares from other shareholders), the more traditional formulations are not available. The policy reasons for adopting a rule of corporate law, supplementing the older remedies, may therefore be considered in a context where those remedies do not fit handily. The following section of this article considers those cases which present the policy problem clearly.

B. Actions Against Managers or Controlling Shareholders Who Do Not Deal Directly With Selling Shareholders

Two cases raise the principal issues to be considered in this section:

Case C. Buyer Initially Negotiates for Purchase of All of the Shares. Buyer wishes to acquire undiluted control of Corporation C by buying all of its outstanding voting shares, 50,000 in number, for which he is willing to pay their book value ($180,000) plus $50,000. He approaches D, who is the owner of a majority or controlling block of shares, and discloses his proposition. D may or may not also be an officer or director. D is anxious to sell his shares at a favorable price in excess of book value. Although D realizes that he might make additional profits by buying the shares of other shareholders or by advising them to sell to Buyer as in Cases A and B, he is unwilling to incur the risks involved in such a transaction. He does not, however, insist upon Buyer's offering the same price for all outstanding shares, but accepts something substantially in excess of book value for his own shares and leaves Buyer to his own devices in bargaining with the other shareholders for a sale of their shares at book value or slightly above. Neither D nor Buyer discloses that Buyer has purchased D's controlling shares; Buyer purchases all other outstanding shares at a lower price per share than D has received.

Case D. Buyer Negotiates for Purchase Only of the Controlling Shares. Instead of revealing to D his interest in acquiring all of the shares, Buyer purchases D's majority or controlling
block of shares at a price substantially in excess of book value per share. More or less contemporaneously, Buyer purchases all the remaining shares in separate transactions and at a lower price per share than D has received.

In Case C, the manager or controlling shareholder has not communicated with the selling shareholders directly or otherwise established contacts with them with respect to this particular transaction. Selling shareholders might, nevertheless, claim from D a proportionate part of the amount he has received per share in excess of the amount they have received. Accustomed to couching such a claim in terms of "fraud," they might make the following argument. Buyer wished to acquire all of the shares at the price favorable to all shareholders and known to D. D permitted the selling shareholders to sell in ignorance of the fact that Buyer was willing to pay such a price for the enterprise as a whole. Had they known of Buyer's plan, they would not have sold or would not have sold at the price they did. By D's failure to disclose, they were misled. Doctrinally, D's participation in the transaction might be denominated by them an "implied misrepresentation" effected through Buyer's communication to them of his offering price, with D's acquiescence and with D's knowledge that such offering price did not reveal D's and Buyer's real objectives. Such an argument no doubt goes to the frontier of the concept of "misleading conduct." Realistically the issue is squarely whether the law should recognize that community of interest among all shareholders which requires that a sale of the corporate enterprise, even through a sale of shares, should inure to the benefit of all shareholders whose shares are necessary for its consummation and not merely to those who have its control in hand.

*Tryon v. Smith* \(^{68}\) involving much the same facts as Case C, represents one court's approach to the problem; the underlying corporate issue seems not to have been examined adequately. A bank president sold seventy per cent of the bank's shares to Transamerica Corporation at a price per share in excess of the price other shareholders received. \(^{69}\) The court rejected selling shareholders' claim that the president had

\(^{68}\) 191 Ore. 172, 229 P.2d 251 (1951).

\(^{69}\) The defendant stated to Transamerica that he would have "... nothing to do with any of the stock except the controlling interest of the stock in which I am interested, including my own and that of my family." He informed the buyer that it would have to deal directly with the minority group, although he also indicated that he thought the minority shareholders should receive at least $220 per share. Book value was $200 per share; actual sales ranging from $160 to $170 per share had been made before the time of the transaction, "to the knowledge of some of the minority shareholders." Transamerica paid $220 per share to minority holders, while the president and his family received $460 per share for their shares. *Id.* at 174-77, 229 P.2d at 252-53; *cf.* McCord v. Martin, 47 Cal. App. 717, 191 Pac. 89 (1920).
breached his duty as a director and as president by failing to advise them that there was such a discrepancy in price.\textsuperscript{70} Selling shareholders had claimed also that he had received additional amounts because Transamerica had obtained their shares at the lower figure. The court observed that there had been no fraud, duress, domination or interference in the sale of plaintiffs' shares and no fiduciary duty resting on majority shareholders to inform the minority shareholders of the price or terms of sale or of Transamerica's original offer. If the court was rejecting an argument that the plaintiffs had been misled, it can only be supposed that it felt bound by traditional concepts of fraudulent misrepresentation. Its reference to "no fiduciary duty" indicates that it was at the same time refusing to examine broader policy considerations. As in Cases A and B when they are stripped of their overtones of "misleading conduct," the question is whether the owner of a controlling block of shares should be permitted to benefit, to the exclusion of non-controlling shareholders, from the sale of his controlling block when he knows that Buyer is purchasing the entire enterprise through the mechanism of a sale of shares. A subsidiary question is whether the law should treat the owner of a controlling block who is also a director or officer differently from the owner who does not technically occupy an official position.

A comparison between a purchase of all of the corporation's assets and of all of its outstanding shares may help to pose the issue.\textsuperscript{71} When purchasing all of the assets, a third party is presumably not interested in how the price he will pay for them will be distributed among the

\textsuperscript{70} Transamerica told "at least some" of the minority shareholders that the defendant and his associates were to receive more for their shares than Transamerica offered to pay to minority shareholders. The court stated that the evidence in the record sustained only the allegations that Transamerica offered to pay to the defendant, for all of the shares, the book value of the shares plus $500,000. 191 Ore. at 177, 229 P.2d at 253. It does not conclusively appear whether or not the plaintiffs knew how much defendant received for his shares. But the opinion is written in terms which indicate that, even if plaintiffs did not know this fact, the court would nevertheless deny recovery.

\textsuperscript{71} The comparison is intended to suggest that, just as a shareholder's proportionate interest in assets is protected at the time of their sale, so also should his proportionate interest in the enterprise as a whole be protected when a sale of control involves a sale of his own shares. Therefore, it is not suggested that recognition of that proportionate interest should be confined to the case in which a sale of shares is followed by the buyer's liquidation of the corporation and his acquisition of "title" to the assets. Of course in that latter case analogy to a sale of assets may be particularly close; compare the treatment which has been accorded to specific instances of that narrow situation in the area of tax law. Kimbell-Diamond Milling Co. v. Commissioner, 14 T.C. 74 (1950), aff'd, 187 F.2d 718 (5th Cir. 1951), cert. dented, 342 U.S. 827 (1951); In re. Brow. Cons. 1954, §§ 334(b) (2) and (3). See also the manner in which the courts have accorded to shareholders, upon a sale of assets, remedies similar to those specifically provided in connection with mergers. Marks v. Autocar Co., Civil No. 16075 (E.D. Pa. 1954), reported in 131 Legal Intelligencer 423 (Philadelphia, Pa., Oct. 14, 1954); Bloch v. Baldwin Locomotive Works, 75 Pa. D. & C. 24 (Delaware County C.P. 1950).
shareholders. All shareholders have a proportionate interest in the price received for the assets, and no shareholder may with impunity divert to himself the proceeds of such a sale. Directors are under an obligation to bargain with the prospective purchaser for the best price obtainable for the assets, and although their judgment is subject to review by a majority of the shareholders, a "side payment" by the purchaser to the directors may hardly be retained by the latter.\(^7\) In a situation involving a sale of all of the assets, even the minority shareholder is not always without some bargaining power since under some statutes he may dissent from the sale and withdraw from the corporation upon receipt of the value of his shares determined according to a statutory formula.\(^7\) The purchaser may have to pay a higher price for the assets than he originally anticipated in order to overcome the possibility of dissent by holders of a large number of shares and the consequent withdrawal of assets to pay dissenting shareholders.

If the *Tryon* case is to be followed, such protection is not accorded to the selling shareholder. The major fact which is eventually disclosed in a sale of assets is the price which the purchaser is willing to pay for them. In a situation involving the purchase of all outstanding shares under the circumstances detailed in Case C, that fact is never disclosed to the selling shareholders in general, but only to the control group. Of course, the individual small shareholder always has the opportunity to decline to sell his shares to Buyer and thus attempt to evoke a higher offer for his shares. He is, however, never able to judge accurately the point to which he may safely raise his demands, since he lacks knowledge of the significant fact that Buyer has expressed a willingness to pay a specified amount for all the shares. A rule which would permit the control group to retain the excess in price which they have received may lead to Buyer's obtaining all of the corporation's shares for a smaller expenditure than he would have to make if all shareholders had more accurate knowledge of the extent of his desires. Shareholders have lost an opportunity which should have been available to all of them in view of the fact that Buyer had expressed a willingness to pay a specified price to acquire a complete enterprise. Their loss is directly traceable to the fact that the controlling shareholders were willing to stand by and permit this loss to occur because they had obtained a satisfactory price for their shares. If the controlling shareholders are also directors or officers of the corporation,


\(^7\) E.g., ILL. ANN. STAT. c. 32, §§ 157.72, 157.73 (Smith-Hurd 1954); N.Y. STOCK CORP. LAW §§ 20-21; ORE. REV. STAT. §§ 57.511, 57.516 (1953).
it would not appear that their obligation to disclose the price which a third party is willing to pay for the enterprise should be any less in connection with a sale of all of the shares than in connection with a sale of all of the assets.

Thus far in the discussion of Case C, it has been emphasized that the obligation to disclose Buyer's price should rest upon a selling shareholder who is also an officer or director. In the *Tryon* case it was implied that freedom from liability to account to the selling shareholders resulted because the defendant was acting as a shareholder when he sold control. Assume for the moment that one who is solely a shareholder has no liability in such circumstances. That does not mean that one who is a manager-shareholder is likewise free from liability. The assumption of the *Tryon* case is that it makes a difference whether Buyer deals with D in his "capacity" as shareholder rather than as manager. Although the ultimate form of the transaction gives D the appearance of having dealt with Buyer only as a shareholder, the fact may be that Buyer did not originally approach D as shareholder, but as a manager. If D was approached to exercise powers attendant upon his managerial position, it is difficult to see how he could, consonant with responsibilities attendant upon that position, convert the proposed transaction into a private one. By what standards is it to be determined that one who is in fact the controlling center of a corporation was approached as a shareholder rather than as a manager? When Buyer proposes to D that all the shares be purchased, he may have several practical objectives in mind; at least two are the purchase of D's shares and the communication of Buyer's proposal to the rest of the shareholders. The latter involves obtaining access to the shareholder list and the use of D's influence to interest the shareholders. It may be a matter of indifference to Buyer whether that influence is to be exerted by D as the controlling shareholder or as the technical occupant of an office which opens a direct line to the shareholders. Therefore, even though D has not carried the transaction through to the shareholders by using the facilities of his managerial position, he may initially have been given the opportunity to do so, at least in part because he occupied that position. The determination of the "capacity" in which D was approached by Buyer is subject to more speculation than to proof; even as to proof, because of its speculative nature it is subject to manipulation which may not necessarily be dishonest. The result of attempting to draw a distinc-

---

74. "No case has been cited holding that a fiduciary relationship exists between majority and minority stockholders under facts comparable to the facts in this case." 191 Ore. at 181, 229 P.2d at 254.
tion between $D$'s capacities would be, in practice, a rule either of unenforceable disclosure or of privileged nondisclosure.\textsuperscript{75}

In *Porter v. Healy*,\textsuperscript{76} the fact that defendants were shareholders as well as managers did not free them from liability in connection with their sale of controlling shares. In that case the controlling shareholders cast the transaction in such a form as to make it unmistakeable that they had appropriated funds which would have been paid to minority selling shareholders if the true facts had been disclosed. Ostensibly the same price was paid by the buyer for all shares, but a bonus was paid to sellers of controlling shares and divided arbitrarily among them. Members of the controlling group had been officers and directors of the corporation; they were held accountable to selling shareholders for a proportionate share of the bonus. The court found a doctrinal basis for the result in the defendants' violation of managerial duties; the defendants had resigned their offices in connection with the sale, and the court was able to say that the defendants had sold their influence and positions as directors. By discounting facts which might have been used to support a theory of recovery based on misleading conduct\textsuperscript{77}

\textsuperscript{75} In the field of so-called corporate opportunities it may be easier, than in the situation discussed in the text, to determine the capacity in which one holding a managerial position was approached with a proposed transaction. Thus, an outsider's offer to sell a patent may more clearly have been extended to a manager in his individual capacity than an offer to purchase all of the outstanding shares of the manager's corporation; as noted in the text, the latter requires the involvement of other shareholders through the manager-shareholder's position in the corporate structure, the former does not necessarily involve the manager's corporation. But in the field of corporate opportunities, even though it may be proved by some acceptable standard that an outsider has approached a manager in the latter's individual capacity, that fact does not conclusively establish that the manager may appropriate an offered transaction for himself. In Johnston *v.* Greene, 121 A.2d 919 (Del. 1956), that was only one of the facts which precluded a corporate accounting from the defendant (the corporation's president, director and indirect substantial shareholder), who had purchased a patent which his corporation might have purchased. The court's inability to find the requisite corporate "interest or expectancy" in the patent offer was a significant factor in the result. The court reversed the judgment of the Court of Chancery, which had held that such an interest existed. Greene *v.* Allen, 114 A.2d 916 (Del. Ch. 1955), 104 U. PA. L. Rev. 424. The chancellor had stated that his conclusion was not altered by the fact that the offer had come to the defendant manager in his individual capacity. "The character of the opportunity does not rest upon so narrow a base. Rather, it depends upon broader considerations of fiduciary duty. The 'formal' acceptance of an opportunity as an individual matter cannot convert a corporate opportunity into an individual one." *Id.* at 919. The writer believes that this proposition is a proper statement of the law and that the reversal of the judgment did not effect a repudiation of the chancellor's reasoning in that respect. The classic statement in Guth *v.* Loft, 23 Del. Ch. 235, 271, 5 A.2d 503, 510 (Sup. Ct. 1939), of the circumstances under which an officer or director is entitled to treat an opportunity as his own indicates that the fact that an offer has come to the manager in his individual capacity is only one of several prerequisites to his freedom to continue to deal in that capacity.

\textsuperscript{76} 244 Pa. 427, 91 Atl. 428 (1914).

\textsuperscript{77} In fact, a letter had been sent to minority shareholders by the buying group, over the names of the defendants. The defendants had agreed to send such a letter but had not done so, and only one of the directors knew that it had been sent. The letter stated that the majority shareholders had sold their shares at the same price.
and by granting relief directly to shareholders rather than requiring that such redress be given to the corporation, the court rejected orthodox theories for a result recognizing the shareholders' common interest in the enterprise. In contrast with the *Tryon* case, the fact that the defendants occupied a shareholder position did not divert the court. The *Porter* case does leave open the question whether, in a case in which the officers and directors do not resign, they will nevertheless be subject to liability for selling their controlling shares in the situation posed by Case C. It will be suggested hereafter in greater detail that the fact of resignation from office serves primarily to provide a convenient doctrinal basis for a court's action, but that it is not a *sine qua non* of the fundamental fact that corporate control was sold and that those who sold it benefited to the known exclusion of other shareholders whose shares were useful to that end.

A more difficult problem is whether one who is not technically a holder of an office or directorship should be held accountable for a bonus or excess price received for his shares on the facts of Case C. The convenient rationalization that he has sold an office is not available. The lack of that rationalization should not be an insuperable impediment. The courts have increasingly looked into the activities of controlling shareholders as such and have imposed restraints, accountability and other sanctions upon them for conduct inimical to the interests of non-controlling shareholders, adapting older doctrines to reach the desired result. There are, however, particular objections which controlling shareholders have interposed as justification which require examination, particularly the argument that nondisclosure of their participation in the control sale in Case C is of no significance since a controlling block of shares has more "value" than a minority block. The implication is, of course, that the excess value is appropriately retained by the seller of the controlling block.

There is first a question whether there is more or less "value" to a control block than has been paid in a particular case, a question not raised in *Tryon* because the "no-fiduciary duty" rule foreclosed investigation. But more significantly, the statement that controlling shares have more value than others begs the question. At most it is a statement of economic fact: the effect of supply and demand. But that fact

---

78. See p. 807 infra.

79. See pp. 805-06 infra and note 221 infra.
is not always a legal justification for retention of the amount received as a result of its operation. A person is in a "valuable" position so long as someone is anxious to bribe him. Closer to the present issue, majority shareholders are in a "valuable" position when they are voting to sell all the assets. In the latter case, a side payment to the majority shareholders by the purchaser of the assets to induce the vote is not justifiably retained by them. On the present issue, it is quite possible that if the controlling shareholders were to reveal to all shareholders that Buyer was willing to purchase all shares at a price in excess of their current market or book value, he would receive considerably less for his shares than if he kept the information secret. If he should insist upon a higher price, the presence of higher demands by other selling shareholders might effectively tend to equalize the amount each shareholder would receive, making the "value" of controlling shares fall. A value subject to such fluctuation suggests that part of the "value" of controlling shares is attributable to the other selling shareholders' ignorance and serves as a bribe to induce the controlling shareholder not to disclose the facts to them.

A rule requiring accountability from controlling shareholders in Case C, as well as from managers and controlling shareholders in Cases A and B, finds its justification in the requirement of fair conduct on the part of those who are in the best position to receive and communicate to other shareholders not so situated the opportunity to sell the enterprise as a whole at a favorable price. All of the shareholders either have invested capital at risk or have continued to hold investments at risk in the enterprise. The peculiar value of that enterprise to a buyer cannot be allocated disproportionately in any rational way among the various management and shareholder groups making up the institution. Strict responsibility to disclose such opportunities would admittedly be but one factor in the heightening of that protection for the small investor which is so vital to the continuance of the smaller corporate enterprise, but it is a factor well worth encouraging. Justification for a rule of no responsibility has rarely been articulated in the particular contexts studied here. Those justifications which have been made, or which can be imagined, do not have sufficient weight to alter a rule of fair conduct. (1) That the controlling shareholder is merely obtaining the "value" of his shares is at best an unanalyzed proposition and, as observed, begs the question. (2) That it is too much of a burden on managers, when trading in shares, to

80. See Donalson v. Investors Realty Corp., 16 Del. Ch. 20, 25, 139 Atl. 766, 768 (Ch. 1927); cf. Southern Pac. Co. v. Bogert, 250 U.S. 483 (1919); Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1942); see also Stott v. Stott, 238 Mich. 547, 242 N.W. 747 (1932); Dieckmann v. Robyn, 162 Mo. App. 67 (1911).
reveal "all they know" is a truism which proves too much and does not meet the specific narrow issues in these cases.81 (3) That shareholders will lose the incentive to accumulate controlling shares assumes that it is desirable to encourage that activity, an assumption which is not self-evident. It ignores other practical incentives, such as the controlling shareholder's freedom while he holds such shares. In addition, the assumption ignores the fact that increased accountability in the cases under question would tend to afford incentives to many small shareholders to invest with assurance of fair treatment. (4) That managers should be entitled to supplement their compensation by share trading in general and by control sales in particular is at best an explanation for judicial non-action in the share trading cases.82 Examined in the light of day it could hardly serve as legal justification for such laxity. That executive compensation should be a matter of full disclosure and the object of public debate seems too clear for extended discussion.

Case D, on the other hand, poses slightly different problems. There, as noted, the controlling shareholder is approached for a sale purely of control, and Buyer's desire for all of the shares, or his expected investment in all of the shares, is not made known to the controlling shareholder. D in such a case can positively assist other shareholders only if he discloses that he is selling control and at what price, or if he refuses to sell unless Buyer makes an even-handed offer to all shareholders. In such a case, requiring D's assistance to other shareholders cannot rest on a need to prevent his diversion of existing opportunities from other shareholders. Nor can it rest on an extension of the theory of misleading conduct unless D knows that Buyer is purchasing other shares at a lower price. Adoption of a rule of accountability must necessarily rest on other reasons for depriving D of personal benefit from a sale of control. Discussion of such other reasons is deferred until a later part of this article, where the question of the place of selling shareholders in the administration of the policies suggested there will be examined.83

II. ACTIONS UNDER THE FEDERAL SECURITIES STATUTES

The rights of the shareholder whose shares have been sold in connection with a plan by a third party to acquire control of a corpora-

81. Compare Walker, supra note 50, at 639, with Berle, supra note 50, at 837.
82. Loose ethical practices in share trading may have been the outgrowth of the corporate practice in earlier times of not paying substantially for directoral or even managerial services. See LATTY, INTRODUCTION TO BUSINESS ASSOCIATIONS 420 (1951); Hurff, SOCIAL ASPECTS OF ENTERPRISE IN THE LARGE CORPORATION 107 (1950); DOUGLAS, DEMOCRACY AND FINANCE 47 (1940); BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 225 n.6 (1932).
83. See note 273 infra.
tion have been considered heretofore in this article in a common-law context. The federal securities statutes have, of course, had significant impact upon many aspects of the securities trading process.\(^{84}\) Insofar as they relate to share trading by managers and controlling shareholders, the statutes were drafted in the framework of the basic assumption that managers and, a fortiori, controlling shareholders should not be absolutely prohibited from participation in such trading. However, the statutes permit examination of particular aspects of the trading process. As observed in the foregoing discussion of selling shareholders' remedies under state law, the courts have, in the main, viewed the problems raised by transactions in corporate control from the standpoint of share trading rather than of corporate policy. The federal statutes do not change that fundamental orientation; it is therefore necessary to determine whether they provide any particular machinery for analysis of the rights of the several parties concerned in a sale of controlling corporate interests.

Two sections of the Securities Exchange Act of 1934 have particular significance in connection with the problems raised by the four hypothetical cases previously considered; they are section 16(b)\(^{85}\) and section 10(b).\(^{86}\) In the context of those cases, the Securities and Exchange Commission's rule X-10B-5,\(^{87}\) adopted in implementation of section 10(b), is particularly important. Section 16(b) has received widespread attention because of its general applicability to share trading by corporate managers and substantial shareholders. In the context

---

84. The statutes of primary interest in this article are cited in note 4 supra.


86. "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 48 STAT. 891 (1934), 15 U.S.C. § 78 (1952).

87. "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

of the problems considered in this article, its effect is limited. Therefore section 16(b) will be examined to point out its limited impact and to demonstrate the need for resort to the more penetrating remedies afforded by section 10(b) and its implementing rule.

Section 16(b) does not provide direct relief to the selling shareholder as such. However, the section has impact upon the factual situation involved in hypothetical Case A. As will be observed, the causes of action created by the section do not run to the selling shareholder in that capacity; they do, however, operate in such a way as to discourage the manager or controlling shareholder from entering into the particular transaction involved in Case A which might give rise to the selling shareholder's complaint. Section 16(b) furnishes a cause of action to an issuer of securities to recover "short swing profits" realized by a defined class of persons frequently referred to as corporate "insiders"—officers, directors and beneficial owners of more than ten per cent of certain classes of securities. The profits recoverable are those resulting from purchases and sales of equity securities within a six months period. As applied to the facts of Case A, if D (the manager or controlling shareholder) (1) is a member of the class of corporate insiders affected by the statute, (2) purchases shares of a selling shareholder and (3) sells shares to Buyer within a six months period, his profits from the transaction will be recoverable by the corporation.

In several respects the statute provides an easier remedy against D than is furnished by the common law. (a) So long as D fits into the statutory class of insiders subject to the statute, it is unnecessary for the complainant to prove that D owed a "fiduciary duty" to anyone, that he factually controlled the corporation or even that a transfer of control was involved. (b) It is unnecessary for the complainant

88. Section 16(b) gives a cause of action to the issuer; in the event that the issuer fails or refuses to institute the suit within sixty days after request, or fails to prosecute a suit diligently, the owner of any equity security of the issuer may institute suit in the name or on behalf of the issuer. Thus it may be only coincidental that a selling shareholder is the holder of some other security and therefore in a position to prosecute a suit under the section with reference to transactions in his shares.


90. Section 16(b) applies to "every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security . . . ." 48 Stat. 896 (1934), 15 U.S.C. §78p(a) (1952). As to "officers" who are covered by the statute, see Colby v. Klune, 178 F.2d 872 (2d Cir. 1949); Lockheed Aircraft Corp. v. Campbell, 110 F. Supp. 282 (S.D. Cal. 1953).

91. See Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943).
to prove that D made any representations or failed to disclose any facts to the shareholder who sold to him.

It should not be thought, however, that section 16(b) has supplanted the need for the development of adequate state remedies for selling shareholders. In the first place, it does not cover all classes of corporations in which the facts of Case A might arise. Since the only profits recoverable are those realized from transactions in the equity securities of an issuer which has an equity security registered on a national securities exchange, transactions in the control of "unlisted" corporations are completely untouched by the section. It is more likely that controlling shares will be capable of concentration in the hands of a single person or cohesive group in the case of smaller corporations than in the case of larger, listed corporations. It is therefore more likely that transactions in controlling shares will occur in connection with such unlisted companies and that the bulk of the cases will not be affected by section 16(b).22 In the second place, even if the statute does reach the particular transaction, it does not afford the selling shareholder compensation for his loss of an opportunity to offer his shares to Buyer at Buyer's favorable price. The profits recoverable under the statute are paid into the corporation's treasury; the selling shareholder, no longer a shareholder of the corporation, does not benefit by that recovery. Only in the case in which D has purchased

22. Since registration of a security on an exchange is effected on a voluntary basis, the impact of § 16 may be avoided by an issuer's choosing not to register any of its equity securities on an exchange. In the past, the Commission has proposed amendments to the Exchange Act which would have required registration of the securities of certain issuers with $3,000,000 or more in assets and 300 or more security holders. In addition to requiring the filing of reports with the Commission and extending the provisions of § 14 of the Exchange Act (relating to proxy solicitation) to such issuers, the Commission's proposals specifically brought such issuers under § 16. The proposals were first introduced in the House in 1946 and, as the so-called "Frear Bill," in the Senate in 1949. See Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S. 2408, 81st Cong., 2d Sess. (1950). The Commission documented the need for its proposals in two reports: SEC, A PROPOSAL TO SAFEGUARD INVESTORS IN UNREGISTERED SECURITIES (1946), and SEC, SUPPLEMENTAL REPORT TO CONGRESS ON A PROPOSAL TO SAFEGUARD INVESTORS IN UNREGISTERED SECURITIES (1950). The proposals were not enacted. Bills substantially embodying the provisions of the Frear Bill were introduced in the 84th Congress: S. 2054 by Senator Fulbright on May 24, 1955, and H.R. 7845 by Representative Klein on August 2, 1955, applying to certain issuers with $5,000,000 or more in assets and 500 or more security holders. See Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S. 2054, 84th Cong., 1st Sess. (1955). A revision of S. 2054, reported to the full committee by the subcommittee and reflecting some of the recommendations made by the Commission at and after the 1955 hearings, would make the provisions of the bill applicable to certain issuers having total assets exceeding $2,000,000 and would require registration with the Commission of (A) each class of equity securities held of record by more than 750 persons and (B) each debt security registered pursuant to the Securities Act where the outstanding principal amount of the class exceeds $1,000,000. Although the bill as reported would extend §§ 14 and 16 to issuers so registering, the Commission has recently recommended that the bill be revised further to exclude the applicability of § 16(b) pending further study. See SEC REPORT ON S. 2054 TO THE SENATE COMMITTEE ON BANKING AND CURRENCY (Committee Print 1956).
merely a part of the selling shareholder's shares for resale, or in which the selling shareholder has subsequently purchased new shares in the corporation, does the corporate recovery benefit him by supplementing the assets underlying the shares he then owns. Finally, section 16(b) leaves almost completely untouched the cases represented by hypothetical Cases B, C and D, in each of which D has purchased no shares from selling shareholders in contemplation of resale but has merely sold his own shares and either acted as intermediary in the shareholder's sale to Buyer or assiduously kept away from direct contact with the other shareholders.83

Thus, despite the fact that section 16(b) works as a strong prophylaxis to prevent the diversion of opportunities which should be made available to shareholders, its application to only a limited portion of the control transaction cases frequently makes it necessary for a selling shareholder to resort to his state law action or to bring his claim under some other part of the federal securities statutes.

It is in section 10(b) and rule X-10B-5 that the selling shareholder can find his major potential source of relief from unfair treatment in a control transaction. Aside from the question whether the section and rule substantively comprehend the hypothetical cases under consideration, there are questions of procedure and jurisdiction which arise at the outset. Judicial determination of the reach of section 10(b) has been focused largely on those procedural and jurisdictional questions raised principally because the language of the section and rule is not very specific. From the reported cases has come the consistent ruling that a civil remedy is afforded to a selling shareholder in the event of the violation of the rule, even though a civil remedy is not expressly provided by the statute.84 In addition, several courts have concluded that the application of the section is not limited to transactions on a national securities exchange or on the over-the-counter professional markets;85 because of inadequate statutory guides,

---

83. The statute does reach one type of case which might grow out of Cases B, C and D, for which the common law has no remedy. If any of the shares which the insider sells to Buyer were purchased by him in the six months period, he must disgorge any profit from their sale even though the shares were not purchased in contemplation of their resale to Buyer.


various theories have been advanced to support those conclusions. With respect to actions by sellers of shares against purchasing managers or controlling shareholders, the major limitation upon section 10(b) is its application only to transactions in which there has been "... use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. ..." Judicial willingness to hold that the statute has been violated, even if the fraudulent act was accomplished only in connection with the use of the mails, makes the limitation less narrow than might appear from the language of the statute; several courts have held that there need be no allegation or proof that a particular fraudulent misrepresentation was mailed or otherwise transmitted by interstate means. Positing the required minimum use of the jurisdictional media of section 10(b), therefore, it appears that in the transactions considered heretofore in this article, selling shareholders have recourse not only to remedies available under state law, but also to those which may be afforded by section 10(b) and rule X-10B-5.99

A selling shareholder may find recourse to section 10(b) and rule X-10B-5 desirable for two reasons. In the first place, his substantive rights may be greater than those afforded by applicable state law in a particular jurisdiction. That proposition will be examined more fully hereafter. In the second place, a major procedural benefit accrues to the selling shareholder suing under the Exchange Act: that is the availability of extra-territorial service of process, a procedure particularly attractive in the corporate field because of the interstate jurisdiction.

96. See Fratt v. Robinson, 203 F.2d 627, 631 (9th Cir. 1953).
97. See Slavin v. Germantown Fire Ins. Co., 74 F. Supp. 876 (E.D. Pa. 1947) (complaint dismissed for want of jurisdiction). On appeal, Slavin v. Germantown Fire Ins. Co., 174 F.2d 799 (3d Cir. 1949), defendants conceded that the mails had been used in connection with the questioned transaction; judgment was reversed on the ground that the district court had erroneously dismissed for want of jurisdiction, and judgment was directed to be entered for defendants on the merits.
98. Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Northern Trust Co. v. Essaness Theatres Corp., 103 F. Supp. 954 (N.D. Ill. 1952); see Latty, The Aggrieved Buyer or Seller or Holder of Shares in a Close Corporation under the S.E.C. Statutes, 18 Law & Contemp. Probs. 505, 513-15 (1953), for a comparison of the jurisdictional limitations of § 10(b) with those of § 12(2) of the Securities Act.
99. But cf. Beury v. Beury, 127 F. Supp. 786 (S.D.W. Va. 1954). Motions to dismiss (treated by the court as motions to quash service of process) were granted on behalf of defendants on whom extra-territorial service of process was made by plaintiffs proceeding in a district court on allegations of violations of rule X-10B-5. The court developed a novel and substantial restriction on rule X-10B-5 by holding, in effect, that the rule does not cover violations of common-law rights "... which might have been fully adjudicated and enforced by appropriate action in a state court, (or in a federal court on grounds of diversity of citizenship) before the Securities Exchange Act of 1934 was passed." Id. at 790. On appeal from the order quashing service of process, the court of appeals granted defendants' motion to dismiss the appeal on procedural grounds, but noted that it did not agree with the reasoning of the district court as set forth in the passage quoted above. Beury v. Beury, 222 F.2d 464 (4th Cir. 1955). The opinion of the district court is commented upon in 103 U. Pa. L. Rev. 1098 (1955).
character of many corporations and the geographical dispersion of shareholders and managers.100

A. Actions Against Managers or Controlling Shareholders Who Purchase for Resale or Advise Sale to Buyer of Control

1. Misrepresentation

Section 10(b) and rule X-10B-5 may be examined first from the point of view of their applicability to Cases A and B insofar as those cases involve false representation by the purchasing manager or controlling shareholder. Reported judicial consideration of the substantive content of rule X-10B-5 has been relatively infrequent.101 No reported judicial opinion has involved precisely the problem of the shareholder seeking redress from the manager or controlling shareholder who has purchased shares after falsely stating to the seller that there were no outstanding contracts or negotiations for their resale. The SEC has asserted that the rule has been violated by such activity on the part of managers and controlling shareholders; it has sought injunctive relief and obtained consent decrees directed toward those transactions.102

Insofar as the private rights of selling shareholders are concerned, under the facts of Case A, the section and rule do not appear to be intended as any limitation on the common-law concept of "fraud," 103

101. See Loss, SECURITIES REGULATION 827-44, 1043-66 (1951); Loss, SUPPLEMENT TO SECURITIES REGULATION 328 (1955), for a comprehensive study of the administration of rule X-10B-5.
102. SEC v. Gentile, SEC Litigation Release No. 323 (S.D.N.Y. 1946), involved a suit by the Commission for an injunction against the president of a corporation who owned or controlled 82% of its shares. A third party had agreed to buy all of the defendant's shares at $6.13; under the agreement all shareholders of the corporation had the right to join in the agreement and to receive the same price per share. The defendant purchased minority shares at prices ranging from $1 to $4 per share without disclosure of the agreement or the price available to minority holders. Defendant consented to an injunction restraining him from making any untrue statement concerning (a) the current market price of the corporation's shares, (b) plans for the resale of the shares by defendant, (c) the resale price of the shares, and (d) the right of all shareholders to sell their shares at that price. Defendant made restitution to minority shareholders from whom he had purchased shares.
103. In Fry v. Schumaker, 83 F. Supp. 476 (E.D. Pa. 1947), on a motion to dismiss the complaint, the court upheld a count alleging a common-law cause of action for fraud and deceit and then concluded that a further count under rules X-10B-3 and X-10B-5 also stated a cause of action "... for violations of the Statute and regulations which are, if anything, broader than the common law." Id. at 478.


In SEC Securities Exchange Act Release No. 3634, Dec. 22, 1944, the Commission stated, in response to inquiries as to the extent and application of rule X-10B-5, "Generally speaking, this Rule embodies the broad anti-fraud provisions of Section 17(a) of the Securities Act of 1933. ..." In other contexts, courts have stated that
whatever question there may be as to the extent to which the statute reaches beyond the common law. A false statement designed to conceal the existence of a resale contract and sufficient to support relief under common law should be sufficient to render the purchasing manager or controlling shareholder liable to the selling shareholder under the statute and rule.104

A distinct problem arises when rule X-10B-5 is sought to be applied to Case B, in which the selling shareholder has sold to Buyer and the manager or controlling shareholder has made a false statement designed to induce the sale. That problem is whether the shareholder has a cause of action against someone not a "party" to the sale. Conceivably the rule might be interpreted to create liability when there is a purchase for resale, but not to affect the transaction in which the selling shareholder has sold directly to the third party, induced by the false statement of the manager or controlling shareholder. The difference between the two situations appears to be formal at most; such an interpretation of rule X-10B-5 would have little effect on the transactions in question other than to invite the rule's evasion. As noted previously, it was not a defense at common law that the one who made a false representation had not entered into contractual relations with the person to whom he lied.108 On the face of rule X-10B-5, it would seem that the shareholder can obtain relief in Case B, since the rule makes it unlawful for "any person" to do a proscribed class of acts "in connection with the purchase or sale of any security." The rule does not in terms apply only to one who has taken the ben-

§ 17(a) of the Securities Act and § 10(b) of the Exchange Act are not limited to the common-law concept of fraud. Norris & Hirshberg, Inc. v. SEC, 177 F.2d 228 (D.C. Cir. 1949) (revocation of broker registration for violation of § 17(a)(1) of the Securities Act and §§ 10(b) and 15(c)(1) of the Exchange Act); Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944) (revocation proceeding for violation of § 17(a) of the Securities Act and § 13(c)(1) of the Exchange Act).

104. In Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947), a manager purchased shares at a time when there was an outstanding agreement between the corporation and a third party for the sale of all of the corporation's assets. Selling shareholders, plaintiffs in the case, asked one of the purchasing defendants whether he had made any agreement for the resale of their shares, to which the defendant answered, "No." The court accepted plaintiffs' testimony to the effect that the question also mentioned a sale of the assets as well, in which case defendant's answer was an "untrue statement of a material fact" under rule X-10B-5. However, the court noted that even if plaintiffs had asked only about a resale of shares, the defendant had omitted to state a material fact necessary to make his answer not misleading. Defendants were ordered to account to the plaintiffs. Id. at 801 & n.1.

Other cases in which selling shareholders prevailed on allegations of fraudulent misrepresentations inducing the sale of their shares are Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Northern Trust Co. v. Essaness Theatres Corp., 103 F. Supp. 954 (N.D. Ill. 1952); Fry v. Shumaker, 83 F. Supp. 476 (E.D. Pa. 1947). These cases suggest that the courts may also accord favorable treatment to the selling shareholder who alleges that a defendant manager falsely represented that there were no outstanding contracts or negotiations for the resale of plaintiff's shares.

105. See note 25 supra.
eficial interest in shares involved in the sale. However, there has been introduced into the construction of rule X-10B-5 a concept of "privity" with which selling shareholders may have to contend.

That concept was articulated in *Joseph v. Farnsworth Radio & Television Corp.* Plaintiffs purchased shares of the corporation's stock through an exchange. Subsequently it was revealed publicly that the corporation was in a precarious financial condition and had been in that condition for more than six months prior to plaintiffs' purchases. As a result, the price of the corporation's shares fell, and plaintiffs sold at a loss. Plaintiffs sued certain directors and officers of the corporation under rule X-10B-5 on the ground that the defendants had known of the corporation's financial condition prior to plaintiffs' purchases and had not disclosed it, and that the defendants had published a false financial statement knowing that persons such as the plaintiffs would rely upon it. Apparently to bring the defendants within the language of the rule proscribing activities "in connection with the purchase or sale of any security," the plaintiffs alleged that, also prior to plaintiffs' market purchases and at times during which the defendants knew of the corporation's condition, the defendants had sold certain of their own shares on the exchange. The plaintiffs did not allege either that they had purchased shares from the defendants or, according to the district court's understanding of the complaint, that they had relied upon the false financial statement. The court dismissed the complaint, stating that "a semblance of privity between the vendor and purchaser of the security in connection with which the improper act, practice or course of business was invoked seems to be requisite and it is entirely lacking here." The court of appeals affirmed, per curiam, on the district court's opinion and its own opinion in another case in which it had concluded that "... Rule X-10B-5 extends protection only to the defrauded purchaser or seller." It has been suggested that the district court was importing into rule X-10B-5 a doctrine of the common law limiting the ambit of the defrauder's liability to those persons or classes of persons intended to

---

107. In the court of appeals, however, Judge Frank, dissenting, was of the opinion that the plaintiffs had adequately alleged that, in the purchase of their shares, they had been misled by false statements of material facts concerning the company's financial condition. 198 F.2d at 884 n.2.
110. Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952); see text at pp. 832-35 *infra* for a discussion of the ruling in that case.
be defrauded by his conduct. There is some justification for that construction of the case, in view of the district court's reference to the possibility of plaintiffs' amendment of their pleading to allege reliance upon the defendants' false financial statement. Thus construed, the opinion does not mean that the parties to the litigation must be in contractual privity with each other, in the sense that one has sold shares to the other, although the opinion may be properly criticized for taking a narrower view of the reach of a defrauder's responsibility than is warranted by more modern developments even at common law. However, consistently with that construction of the Farnsworth case, a court could hold that, on the facts of Case B, a manager or controlling shareholder has the required "semblance of privity" with a selling shareholder: he has lied to the selling shareholder with the express purpose of inducing the latter to sell his shares to a third party. It may be argued in opposition to that contention that in Farnsworth the defendants must have known that their failure to disclose the corporation's financial condition would lead unsuspecting purchasers into becoming shareholders, making subsequent loss in the value of their shares inevitable, and that, since the court has denied relief on those facts, it should deny relief also in Case B. That argument is not controlling. Whether or not one agrees that the liability limitation imposed in Farnsworth is proper, there is a difference between the two cases which justifies a difference in result. It is a difference in degree only, which depends upon the extent to which the share transactions of the respective plaintiffs are essential ingredients in the accomplishment of the defendants' purposes. At least in Case B, the selling shareholder's sale is a most essential ingredient; in Farnsworth, the plaintiffs' place in defendants' scheme might be subject to more subtle speculation.

111. 4 STAN. L. REV. 308 (1952), quoted by Judge Frank in his dissenting opinion in the Farnsworth case, 198 F.2d at 884.

112. 99 F. Supp. at 706. However, the court expressly declined to rule on the sufficiency of a complaint alleging reliance on the defendants' statement. In addition, it reverted to a concept of privity of contract by noting the possibility of later sales by the defendants forming "... the basis of privity with these plaintiffs. ..." Ibid. Of course, such privity of contract would correct the defects of plaintiffs' case, but the question is whether so much "privity" is necessary and whether what might be called "privity of communication" would be sufficient to satisfy the rule laid down in the Farnsworth case.

113. If plaintiffs situated as were those in the Farnsworth case were to argue that the managers' failure to disclose the failing condition of the corporation fell within the proscriptions of rule X-10B-5 with respect to plaintiffs' purchases, the defendants would urge that there was no "privity" because the purchases by plaintiffs were only remote and incidental to the sale of the managers' shares and their purchase by others not complaining. Plaintiffs might suggest, however, that their purchases were hardly remote and incidental, making the following argument: it was essential for the managers to conceal the corporation's condition while their
The court appears to have been led into the privity argument by the way in which plaintiffs pleaded their case. Some confusion undoubtedly resulted from the allegation that it was in connection with the defendants' sales that they performed their fraudulent practices. So viewed, it is not strange that the court should question the relevance of plaintiffs' purchases to such sales, hint at the possibility of remedies available to those who bought the defendants' shares and move in the direction of suggesting that there was no connection (or privity) between the defendants' sales and plaintiffs' purchases cognizable under rule X-10B-5. On the other hand, if the plaintiffs had not emphasized defendants' sales but had alleged that it was in connection with purchases by the plaintiffs that the defendants had performed their fraudulent practices of failing to disclose financial condition, the court might have avoided use of the ambiguous privity concept and nevertheless have reached the same result.

It has become evident that courts interpreting rule X-10B-5 hesitate to open the door to litigation of corporate issues which are normally cognizable in state courts; otherwise, failure to disclose acts of mismanagement (such as a waste of assets) might be alleged as the basis for an action under rule X-10B-5 by one who has purchased shares after the event. Farnsworth may represent nothing more than one court's effort to keep the rule from being used (when the fact of a purchase or sale of shares is only incidental to a major issue of corporate management) to examine into the questions of mismanagement normally cognizable under state law in a suit by the corporation or a derivative suit by shareholders. If so, the use of the "privity" concept should be understood for what it is worth in that context: a shorthand declaration of the existence of some rather indefinite limits to the reach of the rule not applicable in a situation like Case B where the sale of shares is really the heart of the controversy.

sales were being made, and it was no less essential to continue to conceal that condition as long as possible to prevent those who had purchased from the managers from seeking rescission of the managers' sales. That continued concealment could be effected only by permitting normal exchange transactions to go through; any effort by the managers to protect those making purchases on the exchange would have involved disclosure of the corporation's condition and would have brought down the managers' house of cards. Therefore, the plaintiffs' purchases were as necessary an ingredient of the managers' "fraudulent" practices as the purchases and sales of the managers' own shares.

114. 99 F. Supp. at 706.

115. The difficulties posed by the "privity" rule have been analyzed in Loss, Supplement to Securities Regulation 371 (1955); Latty, supra note 98, at 520.

2. Nondisclosure

It was observed that, under state law, Cases A and B posed particularly difficult problems when the manager or controlling shareholder did not make a false representation but merely bought shares or assisted in their sale without informing the selling shareholder of his arrangements with Buyer. The language of rule X-10B-5 does not cover merely those transactions in which some communication, false or half true, has passed from the purchaser to the selling shareholder. A purchase of shares, unaccompanied by a disclosure of a contract or negotiations for resale, is encompassed by the language of subsections (a) or (c) of the rule, as a "... device, scheme, or artifice to defraud" or an "act, practice, or course of business which operates or would operate as a fraud or deceit. ..." Whether the courts will recognize that such a purchase does in fact fall within the rule is a further question. A suggested measure of the scope of the rule, i.e., that "... construction of the rule would seem to start with a bias in favor of at least the 'special circumstances' doctrine of Strong v. Repide," 117 suggests the possibility of liability in a direct purchase and resale transaction such as Case A. 118

In considering issues not involving precisely the nondisclosure in question in this article, courts have recognized that liability will attach under the rule when nondisclosure of a material fact is the major basis for complaint. 119 The fact that the defendant has not made a false statement has not relieved him from liability. In judicial determina-

117. Loss, Securities Regulation 827 n.59 (1951).
118. Compare SEC v. Mueller, SEC Litigation Releases Nos. 264, 268 (D. Wis. 1945), in which an injunction was granted against violation of rule X-10B-5 by the president of a corporation, owner of more than 50% of its common stock and allegedly dominating and controlling the corporation. Defendant had offered to purchase common shares at $2 per share but had failed to disclose the book value (more than $40) and net asset value (more than $16) of the shares, the net earnings of the company, an increase in sales of the corporation's products, the over-the-counter market price (between $7 and $10) of the shares and his prior refusal to sell his own shares at less than book value (at the time, $40 a share). The injunction restrained the defendant from purchasing common shares in the future without full disclosure to all shareholders of all pertinent facts bearing on the value of their shares. Note, however, that the defendant and the corporation had supplied the shareholders with some information which was incomplete and, because of the nondisclosures, probably misleading. Consider also the nondisclosures alleged in SEC v. Gentile, SEC Litigation Release No. 323 (S.D.N.Y. 1946).
119. Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951). (See Speed v. Transamerica Corp., 71 F. Supp. 457 (D. Del. 1947), for the opinion on a motion for summary judgment.) See also Kardon v. National Gypsum Co., 83 F. Supp. 613 (E.D. Pa. 1947), on a request for additional findings of fact and conclusions of law, subsequent to the court's opinion after trial in 73 F. Supp. 798 (E.D. Pa. 1947). The court stated by way of dictum that the selling shareholders' cause of action under rule X-10B-5 would have been sustained even if there had been no representations respecting pending negotiations for the sale of the corporation's shares or assets; defendants would have violated the rule if they had merely purchased plaintiffs' shares without disclosing certain inside information. 83 F. Supp. at 614.
tion of the reach of the rule, factual trust and confidence have not been emphasized as the foundation of liability so much as the fact that the rule creates liability for nondisclosures by reason of its language and policy.\textsuperscript{120}

The most revealing indications that rule X-10B-5 will comprehend a purchase of shares by a manager without disclosure of resale contracts or negotiations, as in Case A, are found in \textit{Speed v. Transamerica Corporation}.\textsuperscript{121} and the Commission's report of its investigation of the purchase of shares of the Ward La France Truck Corporation.\textsuperscript{122} In \textit{Speed}, suit was brought by certain former shareholders of Axton-Fisher Tobacco Company against Transamerica Corporation, majority shareholder of the tobacco company, to recover damages resulting from the majority shareholder's purchase of their shares. The majority shareholder had failed to disclose that the tobacco company's inventory had greatly appreciated in value and that at the time of purchase the buyer had formed an intent to capture that increased value by a merger, dissolution or liquidation of the tobacco company. The court found that the purchase of shares under those circumstances violated rule X-10B-5, on the ground that under the rule it "... is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers."\textsuperscript{123} The case indicates that at least in some circumstances nondisclosure\textsuperscript{124} will serve as a basis for complaint by selling share-

\textsuperscript{120} "The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. ... Some courts have called this a fiduciary duty while others state it is a duty imposed by the 'special circumstances.' One of the primary purposes of the Securities Exchange Act of 1934 ... was to outlaw the use of inside information by corporate officers and principal stockholders for their own financial advantage to the detriment of uninformed public security holders." \textit{Speed v. Transamerica Corp.}, 99 F. Supp. 808, 829 (D. Del. 1951).


\textsuperscript{122} Ward La France Truck Corp., 13 S.E.C. 373 (1943).

\textsuperscript{123} 99 F. Supp. at 829.

\textsuperscript{124} The court referred to the nondisclosure in the \textit{Speed} case as creating an "implied misrepresentation." This conception of the defendant's conduct was first articulated to refute defendant's argument that only express misrepresentations and half-truths fall within the proscriptions of rule X-10B-5. \textit{Id.} at 829. The court's description of the duty imposed by the rule (see note 120 \textit{supra}) indicates that the defendant's liability rested upon a policy basis. However, the notion dies hard that the maximum obligation imposed on one in a commercial situation is to refrain from "misleading conduct." On similar facts in \textit{Geller v. Transamerica Corp.}, 53 F. Supp. 625 (D. Del. 1943), \textit{aff'd per curiam}, 151 F.2d 534 (3d Cir. 1945), the same court dismissed a complaint alleging common-law fraud. Its dismissal was based principally on the ground that the defendant had not occupied a "fiduciary relation-
It is further made clear that the liability created by rule X-10B-5 is not to be imposed only upon one who technically occupies an office or directorship; it reaches as well to controlling shareholders.\(^{126}\)

That the rule was not intended to cover only those cases where false representations have been made was indicated by the SEC in the report of its investigation in the *Ward La France* case\(^ {127}\) shortly after the promulgation of the rule. The president and treasurer of Ward La France Truck Corporation held 80 per cent of the voting power of the corporation. They made an agreement with a third party to sell all of their shares for slightly in excess of $45 per share. Immediately prior to their entering into the agreement they procured the purchase of minority shares at prices ranging from $3.25 to $5.75 per share, the purchases being made on behalf of the corporation.\(^ {128}\)

...
The third party proposed that, after obtaining the controlling shares, it would transfer all of the assets of the corporation to itself, vote to liquidate the corporation and then pay the minority shareholders $25 a share. No minority shareholder was informed that the truck corporation was buying the shares, that negotiations were being conducted for the sale of the controlling shares, that the corporation was to be liquidated or that minority shareholders would receive $25 per share on liquidation. In addition, no disclosure was made that the corporation's earnings had been increasing. The Commission conducted an investigation into the purchases. Although the Commission took no formal action, voluntary restitution was made to minority shareholders. In the report of its investigation, the Commission concluded that rule X-10B-5 had been violated, although it did not state specifically whether any particular nondisclosed fact, standing by itself, would have constituted a violation. The transactions violated the rule whether the managers were viewed as having received a bonus payment or as having appropriated the corporation's assets without payment to minority shareholders of their proportionate share of the business.

So far as Case B is concerned, once the determination is made that rule X-10B-5 comprehends cases in which material facts have not been disclosed, the considerations previously noted in the discussion of Case B in a context of false representations are again germane. The major problem is again one of "privity" in the sense in which the term was employed in the Farnsworth case. The manager or controlling shareholder is intimately involved in the sale of the shareholder's interests to the third party and, in effect, is offering a type of brokerage service to them. Thus the limitations of the Farnsworth case again appear not to prevent recovery by the selling shareholder even though the defendant is not, in a technical sense, the buyer of the shares. Reference to the facts of the Ward La France case reveals that no such restriction was envisaged by the Commission, for there the managers were stated to have violated the rule even though the purchases of shares were effected on behalf of the corporation and not directly by the managers; and in at least one reported case in the courts a complaint alleging that brokers had participated in their customers' scheme to acquire shares by misrepresentation and concealment was held to have...
stated a cause of action not only under the Commission’s rules relating to brokers but also under rule X-10B-5. 129

B. Actions Against Managers or Controlling Shareholders Who Do Not Deal Directly With Selling Shareholders

The questions raised by Case C have not been litigated with reference to rule X-10B-5. Insofar as the common-law rule of “no-fiduciary duty” has effectively blocked consideration of the real problems involved in the case of the manager or controlling shareholder who sells his own shares at a high price after negotiations have been opened for a sale of all the shares, the rule may be interpreted to lift that block. 130

It may be argued that, if the requirement of “privity” suggested by the Farnsworth case is to have vitality, it would at least preclude recovery in a case where there are not only no direct contractual relationships between the manager and the selling shareholder but also no communications or other immediate points of contact between them. But, even if Farnsworth is interpreted as posing the question of the liability of the defendants with respect to the plaintiffs’ purchases (rather than the defendants’ sales), it does not cover the facts of the hypothetical case. In Case C (exemplified by Tryon v. Smith), 131 the manager-controlling shareholder and Buyer communicated with each other on relevant matters; a profitable purchase of all of the shares was converted into a purchase profitable only to the defendant, and Buyer negotiated with the minority shareholders on the basis of a price established as a result of his dealings with the defendant. So much participation by the manager-controlling shareholder in the ultimate transaction between Buyer and the selling shareholder, with knowledge of its inevitable effects on the selling shareholders, seems more than sufficient to supply the “semblance of privity” required by Farnsworth. 132

It was suggested that Case D may be decided under state law only on bases of policies which have reference to something more than misleading practices directed toward selling shareholders. 133 Discus-

131. See note 68 supra.
132. However, the pleader may find that he has avoided the privity rule by alleging a “conspiracy.” In that event, recovery under rule X-10B-5 might be precluded if the court followed Citizens Casualty Co. v. Shields, CCH Fed. Sec. L. Rep. ¶ 90683 (S.D.N.Y. 1954) (rule X-10B-5 refers to the effectuating of sales directly and not to conspiracies).
133. See text at p. 758 supra.
sion of the appropriate approach of courts applying state law to sales of controlling interests, made under circumstances in which the other shareholders are not an integral part, has been deferred until those policies may be examined. The problems posed by an attempt to apply rule X-10B-5 to Case D will be similarly deferred.\footnote{184}

On the whole, section 10(b) and rule X-10B-5 offer an opportunity for those courts considering complaints of selling shareholders in connection with sales of controlling corporate interests to reach results more in consonance with obligations of fairness than the common law has permitted. Unlike other parts of the federal securities statutes, more narrowly oriented and restricted in their application,\footnote{185} the rule has afforded an experimental ground for handling a variety of devices used by corporate managers and controlling shareholders to obtain benefits from which the body of shareholders is excluded. If rule X-10B-5 remains in force and if it is not hedged about by judicial restrictions reminiscent of the common law, many of the deficiencies of the common-law cases dealing with the remedies of selling shareholders in control transactions may eventually be corrected.

PART TWO. ACTIONS BY COMPLAINANTS OTHER THAN SELLING SHAREHOLDERS

Thus far in this article inquiry into the purchase of controlling corporate interests has been directed toward those instances in which a selling shareholder has been the complainant. The transaction by which the buyer acquires control may take a form which opens up a real possibility of complaint by other members of the corporate institution. For example, the buyer may purchase only the shares owned by a controlling shareholder, who may or may not be an officer or director. In such a case, the other shareholders continue to own their shares in the corporation after the buyer has acquired control. Even if the buyer purchases not only the controlling shares owned by one person (or by a group acting in concert), but also some additional shares owned by other shareholders, there may still be shareholders who continue to own shares after the completion of the buyer's transaction. Thus there is the possibility of a suit against the seller of the controlling shares by those who may be referred to as the "remaining shareholders"; in such a suit the problems raised are somewhat different from those posed in a selling shareholder's suit.

\footnote{134. See note 273 infra.}

Aside from the question of the remedies available to the remaining shareholders in some instances, there is a problem of the possibility of a cause of action by the corporation on its own behalf. That problem may arise in any case in which the buyer acquires control, whether he does so by way of a purchase of all of the shares, of controlling shares plus some of the other shares or only of controlling shares. The question whether a "corporate" cause of action exists may arise in several procedural contexts, three of which may be mentioned. The directors may authorize the prosecution of such an action in the name of the corporation. Shareholders may bring a derivative suit asserting a corporate cause of action which the directors have failed or refused to prosecute. In case of an insolvent corporation, a receiver or trustee in bankruptcy may proceed as successor to the corporation. An examination of the circumstances under which a corporate cause of action may be asserted, as distinguished from a cause of action prosecuted by selling shareholders or remaining shareholders, is the subject of the immediately following section.

III. ACTIONS UNDER STATE LAW

A. Actions by or on Behalf of the Corporation

The factual contexts in which a corporation may attack a control sale are varied. By way of introduction to a study of those factual situations, it may be suggested that with respect to each of them there is the broad question whether it is desirable to require the seller of a controlling block of corporate shares to account to anyone except a shareholder who has been induced to sell his own shares and has suffered the loss of an opportunity to participate proportionately in the control sale. There have been major obstacles to judicial considera-

§ 78i (1952). See Latty, supra note 98, at 512-15. In his dissenting opinion in Joseph v. Farnsworth Radio & Television Corp., 198 F.2d 883, 884 (2d Cir. 1952), Judge Frank noted that "when the Commission promulgated Rule X-10B-5, it did not deem it 'necessary or appropriate' for the public interest that the restrictions elsewhere imposed should be required in suits under that Rule." Id. at 887.

136. At least with respect to suits involving a sale of control under circumstances suggesting a possibility that the purchaser of control might cause harm to the corporation by appropriating its assets, no significant substantive differences in the liability of the seller of control have been observed that are attributable to the fact that suit was brought, on the one hand, by the corporation or, on the other hand, by a trustee in bankruptcy. Those cases will, therefore, be examined together. It is a major problem, as yet not wholly satisfactorily resolved, whether, in the case of a solvent corporation, payment of a judgment arising out of a derivative suit involving sale of control should be made to the corporation or directly to the complaining shareholders. See Perlman v. Feldmann, 219 F.2d 173, 178 (2d Cir. 1955), and text at p. 821 infra.

137. It has been held that the corporation is not a proper party to prosecute an injunction suit against directors based on an allegation of fraud on selling shareholders. Llewellyn v. Queen City Dairy, Inc., 187 Md. 49, 48 A.2d 322 (1946). The
tion of that narrow problem. One such obstacle has been the dearth
of available legal doctrines which permit analysis of the situation.
Another has been a readiness on the part of the courts to decide the
cases on the basis of the same negative doctrine which blocked the
selling shareholder in cases previously considered in this article,
\textit{i.e.}, that the absence of a fiduciary relationship between a shareholder
and other members of the corporate family forecloses examination of
even a controlling shareholder’s transactions in his shares.

A preliminary look at several of the decided cases will illustrate
the play of that doctrine; it may suggest that the doctrine imposes
serious limitations upon examination of the desirability of a corporate
cause of action in specific factual situations. In \textit{Keely v. Black,} the
president of a corporation sold more than 95 per cent of the out-
standing shares of the corporation to a third party. He had bought
some of the shares from other shareholders in order to deliver control.
In a suit brought by the remaining shareholders, the court declined
to order an accounting to the corporation with respect to a “bonus”
which the president had received from the buyer. It appeared to the
court that the president had acted only as an individual, had received
the bonus for his own services in connection with his purchase of out-
standing shares and had not occupied any fiduciary relationship to
the complainants. The duality of defendant’s position, as a manager
and as the holder of 95 per cent of the corporation’s shares, did not
move the court to ask whether what the defendant had done in one
capacity \textit{(i.e., as shareholder)} had some bearing on responsibilities
which he might owe in his other capacity as president of the corpo-
ration.

\textsuperscript{138} The court intimated that even the selling shareholders had no cause of action, stating:
"Everyone knows, as these shareholders must have known, that purchasers of stock
do not anticipate a loss, but a profit." \textit{Id.} at 60, 48 A.2d at 327-28.

\textsuperscript{139} The court noted, however, that no shareholder from whom the shares had
been purchased for resale was complaining. Whether the court would have required
an accounting to such a shareholder is not too clear, since it has been observed previ-
ously in this article that even selling shareholders have not invariably been granted
relief in such a case. It was a factor influencing the court’s decision that accounting
had been requested to be made \textit{to the corporation.} Since the buyer now owned almost
all of the outstanding shares, the result of such an accounting would have been an
indirect return to the buyer of the major part of the bonus paid to the president.
The court stated that it could not “... conceive of a more unjust and inequitable
result than to force the Bell company to take back this money which it paid in good
faith and for the return of which it does not ask.” \textit{Id.} at 524, 111 Atl. at 23. \textit{But see}
text at pp. 821-26 infra.

\textsuperscript{140} The possible impact of \textit{Brophy v. Cities Service Co.,} 31 Del. Ch. 241, 70 A.2d
5 (Ch. 1949), upon the type of transaction observable in the \textit{Keely} case deserves
note. In that case, an accounting was required of one who was not even a manager
(in the sense of an officer and director) but a “confidential secretary” of a director
of the corporation. Having learned that the corporation was proposing to purchase
some of its own shares, he bought shares on the market; after the corporation entered
Other courts (or other plaintiffs) have been more assiduous in their search for an available doctrine with which to begin examination of the problem. In *Commonwealth Title Insurance & Trust Co. v. Seltzer*, the Pennsylvania Supreme Court refused to be misled by the notion that a transaction essentially single could be divided into a shareholder part and a managerial part. When approached by a third party who wanted to buy a corporation's sole asset (certain real property), the corporation's president indicated to the prospective buyer that the purchase could not be made. Thereafter, the president and another director purchased a sufficient number of shares to obtain control of the corporation and then sold their shares to the third party at a profit to themselves. At a shareholders' meeting held after the third party had obtained control of a majority of the shares, the directors and officers were authorized to accept the third party's offer to purchase the corporation's real property. Immediately thereafter, the defendants and the other directors of the corporation authorized the sale of the property at a price "...which was not found to be inadequate." The cash received for the purchase of the property was then distributed to the shareholders; the principal defendants did not resign from the board of directors until after the board had voted to accept the offer for the purchase of the corporation's property. On a bill in equity brought by minority shareholders, the principal defendants were required to account for the profit which they had made on the sale of the corporation's shares.

The court denied a motion to dismiss a complaint in a derivative suit to compel accounting for the profit, even though the court thought that the allegation that the transaction had been "to the detriment of Cities Service" was insufficient to show loss to the corporation. It was not necessary to plead that a loss had been sustained; it was only necessary for the complainants to demonstrate that there had been a breach of a "confidential relation" by an employee. The court apparently required the accounting as a prophylactic measure to foreclose the use of "inside" information which, in most cases, might result in actual loss to the corporation.

The case poses problems of (a) the theory of the "ownership" of the cause of action and (b) the form of relief. Plaintiffs had requested an accounting either to
Like the New Jersey court which decided the *Keely* case, the Pennsylvania court preserved the symmetry of the law by noting that a shareholder, even though he is a managing officer of a corporation, has the right to buy and sell the corporation's shares and to keep the profits. But the court observed that in this case the defendants were acting as directors in selling the corporation's assets; they had not made certain that the corporation should receive all which the buyer was willing to pay for those assets. In their capacity as managers they had diverted into their own pockets as shareholders a portion of the total consideration which, in reality if not in form, was paid for those assets. For dereliction of their duty as directors, they were required to account even though they had cast the transaction in the form of a sale of stock and despite the fact that the corporation had received at least a "fair" price for the assets.

Because the directors had cast their transaction in two parts, the court was able to pin the label of "fiduciary duty" on what they had done as directors. Had they merely sold their shares and resigned from office, leaving the buyer free to dispose of the assets of the corporation as he saw fit, perhaps even then the court might have held them accountable for their failure, as directors, to effect the sale of assets when it was first proposed.\textsuperscript{47} Beyond that the question arises as to what the court would have done (1) if the buyer had initially come to the defendants with a proposal to buy only a controlling block of shares, the buyer intending to use the power thus acquired to control the disposition of the assets to itself, or (2) if the defendants had themselves, or to the corporation, or to a receiver. *Id.* at 145-46. Thus, their bill was not couched distinctly in terms of a derivative, rather than personal, suit. The trial court found the defendants had committed a fraud on the shareholders, but also found that the profits made by defendants "belonged" to the corporation. *Id.* at 251. Although not plainly articulated, it appears that the trial court viewed the suit in theory as the assertion of a "corporate" cause of action. The supreme court's discussion of the propriety of suit in the name of individual shareholders is indicative of a similar conception of the theory of the suit as one in which shareholders were bringing a corporate suit which they could not reasonably expect the present managers to prosecute; the language of the opinion bears a strong resemblance to the customary language in more modern opinions discussing the propriety of shareholders' maintaining derivative suits. 227 Pa. at 418-19, 76 Atl. at 80.

In determining the form of relief, however, the supreme court affirmed the trial court's direction that accounting be made directly to the plaintiffs. Defendants were required to pay only a portion of their profits, measured by the proportion which plaintiffs' shares bore to the outstanding shares of the corporation. Transcript of Record, p. 248. Since the defendants were not required to pay their entire profit to a representative of the corporation (such as the present management or a receiver), the form of relief did not strictly follow the theory that the defendants' profits "belonged" to the corporation. One basis for explanation of this result may be that "... the corporation had practically gone into liquidation. ..." 227 Pa. at 418, 76 Atl. at 80.

147. The lower court noted, however, that if the defendants had resigned from the board before the sale of assets was authorized, the defendants might have retained the profits made on their stock speculation. Transcript of Record, pp. 250-51.
been merely holders of controlling shares, not formally directors but otherwise effectively controlling the directors' management of the corporation. In either event, a doctrine relating to the duty of directors might have been an insufficient basis for the court to impose accountability on shareholders.

The search for appropriate and usable legal tools to solve such problems has produced varied results in what might be called the "looting" cases. Those cases involve observable depletion of corporate assets. They will therefore be examined before attention is directed toward control sales in which injury to corporate interests is not so obvious.

1. Against Controlling Shareholders When Sale Is Followed by Looting or Looting Is Anticipated

Trafficking in control was one of the serious abuses detected by the SEC in its intensive investigation into the practices of investment companies. Remedial legislation was not the only outcome of such abusive operations; litigation growing out of control transfers has left judicial precedents which may have impact upon transactions involving the transfer of controlling interests in corporations which do not possess the specialized attributes of the investment company. Two major suits were brought against controlling shareholders who had sold their shares, the buyers having used their newly-purchased control to appropriate corporate assets for their own purposes. In short, the buyers "looted" the corporations soon after obtaining access to the corporate treasuries. In one of the cases, Insuranshares Corp. v. Northern Fiscal Corp., the suit was brought in the name of the corporation; in the other, Gerdes v. Reynolds, recovery was sought by a reorganization trustee. In each case, liability was imposed upon the selling group. However, both the theories of liability and the measures of recovery were different.

148. Cf. Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (E.D. Pa. 1940); Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947). In Sautter v. Fulmer, 258 N.Y. 107, 179 N.E. 310 (1932), the court did not discuss whether defendant's liability to a selling shareholder was grounded in his occupation of an office or directorship, as distinguished from his ownership of controlling shares.

149. See SEC, REPORT ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES, PURSUANT TO SECTION 30 OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (1940).


152. 28 N.Y.S.2d 622 (Sup. Ct. 1941); 30 N.Y.S.2d 755 (Sup. Ct. 1941) (confirmation of report of referee to assess damages).
Those differences in theories of liability and measures of recovery are significant in this study not merely in reference to the other looting cases to be considered. Of particular significance is the impact of the cases in this section upon those control transfers which do not result in observable depletion of corporate assets. Running through the looting cases are two different forms of relief. The plaintiff may ask that the transferor of controlling shares be required to pay damages to the corporation measured by the value of the assets appropriated by the purchasers of control. On the other hand, the plaintiff may seek to compel the control transferor to disgorge profits resulting from the control sale; specifically, to give up that part of the price he has received for his shares which exceeds whatever may reasonably be found to be the "value" of the shares he has sold. In reviewing the looting cases, therefore, it should be noted that the plaintiff may ask for both recoveries, or only one. It should also be kept in mind that the profit remedy and the reasons for its being granted or denied will be the focus of attention in those cases, to be discussed in a later section, which involve control sales unaccompanied by looting.

The defendants in the Insuranshares case were shareholders, former officers and directors, and purchasers of controlling shares who had appropriated corporate assets. Of principal interest with respect to

153. If suit is brought by the corporation, or by innocent shareholders asserting a derivative right, rather than by a trustee in bankruptcy, the purchasers of control may conceivably benefit by a recovery from the sellers of control. This possibility should not preclude corporate recovery of damages from the sellers of control. (1) It is factually unlikely that buyers will institute a corporate suit against sellers. If looting is serious enough, a trustee in bankruptcy will have stepped in. If the buyers are still in control, they will hardly institute a suit which will necessarily involve disclosure of their own misconduct. (2) It is not improbable that the looters will have disposed of their share interests to new shareholders after they have used the corporation for their own purposes. In effect that is what was done in the Insuranshares case. See Insuranshares Corp. v. Northern Fiscal Corp., 42 F. Supp. 126, 128 (E.D. Pa. 1941). (3) If the buyers still hold their shares and a derivative suit is instituted by innocent shareholders, the court will be faced with a situation similar to that encountered in the ordinary derivative suit for corporate mismanagement. In such a case, the fact that managers may be shareholders does not preclude corporate recovery from them or even require that relief against them be molded in such a way as to preclude the wrongdoers from sharing indirectly in the proceeds of the judgment. See note 251 infra. Whatever dissimilarity there is between the ordinary derivative suit and the suit involving control transfers rests in the possibility that the sellers of control may be made the sole defendants, thus bearing the whole burden of a judgment for damages which will inure to the indirect benefit of fellow wrongdoers. In that narrow situation, adaptation of the present rules of indemnity and contribution might well be made to permit sellers to recover from buyers all or some part of a judgment for damages paid to the corporation. (As to the problems posed by those rules, see Leflar, Contribution and Indemnity Between Tortfeasors, 81 U. Pa. L. Rev. 130 (1932).) Of course, no right to shift the burden of a judgment for sellers' profits as distinguished from one for corporate loss should be recognized; that liability falls exclusively on the sellers, and along with the risk of the buyers' insolvency should remain as a deterrent to sales of control under circumstances arousing suspicion as to buyers' intentions.

154. See note 246 infra.

155. See text at pp. 797-820 infra.
to the problems under study in this article are the shareholders (banks and individuals) who had sold approximately 27 per cent of the corporation's outstanding shares. The court found that this block was sufficient to constitute practical control of the corporation, although it occupied mathematically only a minority position. Of the defendants who had been served and were therefore before the court, three were banks which had held shares in the corporation and one was an individual who had been their "representative" on the board of directors. The sellers were required to restore to the corporation the losses which had been caused by the purchasers' appropriation of its assets. Although the controlling shareholders had received a price for their shares in excess of the market value as well as the book value of the shares, the corporation did not ask that they be compelled to disgorge their profit, and no part of that excess appeared as an element of the corporation's recovery.

The selling shareholders' liability to account was grounded in two propositions. First, the shareholders were found to owe a "duty" to the corporation which they might not have owed if the transaction had been a mere sale of stock, a conclusion reached apparently from a reading of the "whole record" and from a consideration of the price at which the shares were sold. The former test does not suggest a very significant standard by which to determine the existence of the duty which the court imposed, except for its inferential emphasis on the fact that the particular sale of shares involved in the case resulted in the corporation's loss of assets. With respect to the latter test (the price at which the shares were sold), the court concluded that the defendants had sold "control," basing its decision on the grounds that the sellers had received $3.60 per share at a time when the book value of shares was $2.25 per share and the over-the-counter market price only $1.00 to $1.25 per share. Having thus determined that the controlling shareholders owed a "duty" to the corporation, even though they were not managers, the court then moved to its second ground of liability, i.e., that, in a case in which control is sold, the seller of control will be liable for negligence in connection with the sale; if the circumstances

156. A major loss was caused by the purchasers' sale of plaintiff's portfolio to repay money borrowed by the purchasers to buy the shares of the selling group. In effect, the purchasers had bought the corporation's shares with its own assets.

157. See 42 F. Supp. at 126 for discussion of the measure of damages.

158. Thus, in the search for an applicable concept to supply a "duty" in connection with a sale of shares, the court adopted the technique of other courts which have viewed the transaction as substantially or primarily something different from the form in which it had been cast. Cf. Dunnett v. Arn, 71 F.2d 912 (10th Cir. 1934); Commonwealth Title Ins. & Trust Co. v. Seltzer, 227 Pa. 410, 76 Atl. 77 (1910).

159. 35 F. Supp. at 24.
suggest inquiry and if such inquiry is not made, the sellers must account to the corporation for resulting losses.

The theory of liability in the Insuranshares case was therefore grounded in part on a factual determination that those who occupied a position of power in the corporation had negligently caused loss to the corporation through the medium of an ostensible sale of shares; since the defendants did in fact occupy that position of power they were not relieved from liability merely because they had not occupied some other position of power such as that of an officer or a director. In the second of the investment company cases, Gerdes v. Reynolds, the theory of liability, while not wholly clear when viewed in the factual context, appears to have been more legally than factually oriented. The Gerdes case also involved a sale of controlling shares of an investment company to a buying group which assumed control through resignations of the old board of directors and substitution of new directors; the buyers thereafter "looted" the treasury of the corpora-

160. The court listed five facts which should have led the sellers to an investigation: (1) the corporation had previously been looted in a similar fashion; (2) some of the defendants had been willing to permit another prospective buyer to use the corporation's assets to pay for shares; (3) defendants knew that the buyer wanted to turn some of the assets into cash before the sale; (4) the price for the shares was excessive; and (5) defendants had been warned of risks attendant upon sale of control to irresponsible people. Id. at 25-26.

161. "Without attempting any general definition, and stating the duty in minimum terms as applicable to the facts of this case, it may be said that the owners of control are under a duty not to transfer it to outsiders if the circumstances surrounding the proposed transfer are such as to awaken suspicion and put a prudent man on his guard—unless a reasonably adequate investigation discloses such facts as would convince a reasonable person that no fraud is intended or likely to result. Thus, whatever the extent of the primary duty may be, circumstances may be sufficient to call into being the duty of active vigilence [sic] and inquiry. If, after such investigation, the sellers are deceived by false representations, there might not be liability, but if the circumstances put the seller on notice and if no adequate investigation is made and harm follows, then liability also follows." Id. at 25.

As stated in this excerpt from the opinion, the court imposed an absolute duty to investigate if circumstances should have aroused suspicions. Because the court was convinced that an investigation, if made, would have resulted in discovery of the fact that "looting" was proposed, its statement is probably adequate for the facts of this case. The difficult case arises when there are suspicious circumstances, no investigation by the sellers of control and an attempt by the sellers to prove at trial that an investigation would not have revealed that the buyer might loot the corporation. If the "negligence" doctrine of the Insuranshares case is to be taken seriously, then, at least theoretically, the sellers would have a defense. It could hardly be said that it was negligence to fail to do that which, if done, would not have prevented the subsequent loss to the corporation. In practice, the burden of proving that defense may be so great that sellers will make the investigation in most cases or, if they do not, will find the defense not useful to them in any realistic sense.

162. 28 N.Y.S.2d 622 (Sup. Ct. 1941).

163. New directors were substituted by the following method. One member of the old board resigned, after which the vacancy so created was filled by the remaining members through appointment of a nominee of the buyers. Then another member of the old board resigned, and the vacancy so created was filled in the same manner. Successive resignations and appointments resulted in the creation of a board composed exclusively of the buyers' nominees. Id. at 632. The court recognized that "... in the case of this particular corporation, as in many others, the remaining
tion and used the proceeds in part to pay for the stock purchased. In the Gerdes case there was no necessity to find the existence of "practical" control; legal control had been vested in the selling group, since it owned a majority of the stock. A significant difference from the Insuranshares case was the fact that the selling shareholders themselves occupied offices and directorships in the company, making it unnecessary for the court to create a fiduciary doctrine applicable to controlling shareholders as such. However, since the argument had to be met that shareholders may freely sell their shares, it was necessary for the court to hold that a group of directors and officers who sell their shares may be subjected to liability qua directors, even though they may have cast a transaction in the form of shareholder activity. The trustee was granted both of the forms of relief mentioned above: the defendants were required to account to the trustee for (1) the loss sustained by the corporation as the "proximate" consequence of the sale of control and the turning over of the corporation's assets to the buyers,164 and (2) the difference between the "actual value" of the shares sold by the control group and the price received.165

The basis for the imposition of liability in the Gerdes case is somewhat unclear from the opinion. The court vacillated between two theories, one based upon the defendants' negligence, the other upon the fact that the defendants had received an excessive price for their shares in connection with their resignation from office. Those ideas were developed in the following way. The plaintiff trustee had alleged that the sale of the defendants' shares (accompanied by resignations of directors and officers) was an "illegal transaction" because it had been accomplished in violation of a fiduciary duty owed to the corporation and to holders of debentures, preferred stock and common stock. All directors were specifically authorized to fill vacancies." Id. at 649; cf. Oil Shares, Inc. v. Kahn, 94 F.2d 751 (3d Cir. 1938). Statutes permitting directors to fill vacancies on the board, without notice to or approval by shareholders, facilitate the substitution of a completely new board in the manner employed in the Gerdes case. See, e.g., CAL. CORP. CODE ANN. § 808 (West 1955); DEL. CODE ANN. tit. 8, § 223 (1953); PA. STAT. ANN. tit. 15, § 2852-402(3) (Purdon Supp. 1954). Under § 16(a) of the Investment Company Act of 1940, 54 STAT. 813, 15 U.S.C. § 80a-16(a) (1952), the procedure used in the Gerdes case would no longer be available to directors of investment companies subject to that statute.

164. 30 N.Y.S.2d at 771.

165. 28 N.Y.S.2d at 656-61. Although, in theory, the "profit" from the sale of control was considered by the court to be the "property of the corporation," the defendants were directed to pay a portion of this amount to the trustee of another insolvent corporation from which funds had been diverted to make up a portion of the price paid to acquire control of the investment company. In effect, therefore, the court held that the defendants' clear profit payable to their corporation was less than it would have been had defendants not been required to reimburse another party for funds unlawfully received by them. See p. 826 infra for a discussion of the measure of the liability of a manager or controlling shareholder, required to account to his corporation for "profit" realized in a control sale, when there are selling shareholders who claim a portion of his profit.
ternatively, the trustee asserted that if the sale was not illegal per se, then it was illegal because the defendants had negligently or in bad faith failed to investigate the purchaser or give notice to the other shareholders, and that this was especially true since the excessive purchase price paid to defendants put them on notice of some intended wrongful act.\(^\text{166}\) (The latter position sounds much like the one taken by the court in the *Insuranshares* case.) In its opinion, the court gave verbal recognition to the right of shareholders to sell their shares and pass to the buyer the right to select directors, but noted that a director's right to sell shares or to resign is qualified by a fiduciary obligation which he owes as director.\(^\text{167}\) The court stated that there were two questions to be answered: (1) Were the circumstances such as to charge the resigning directors with notice that unlawful plans and designs of the purchasers were "... reasonably to be perceived"?\(^\text{168}\) (2) Was the price paid in reality a price for stock or at least in part for the resignation of the officers and the election of the buyers' nominees? The first of these questions, as well as the court's observations about the nature of the assets ("practically negotiable securities")\(^\text{169}\) and the method of consummating the transaction, indicates that the court was moving in the direction of imposing liability upon the managers of the corporation because of their negligence (as did the court in the *Insuranshares* case). However, the court's subsequent examination of the price paid for the shares demonstrates that it was shifting toward the proposition that the receipt of that price in connection with resignation from office was a more significant liability determinant. Having found that the shares had a "value" of, at most, 75 cents a share\(^\text{170}\)

166. 28 N.Y.S.2d at 649.

167. The court noted that if officers, directors or stockholders actually knew that the purchasers of control intended to loot the corporation, liability "... would not have to be predicated upon breach of a fiduciary relation, for the act would amount to a willful and malicious injury to property, tortious in its very nature." 28 N.Y.S.2d at 652. The court found no such knowledge and thus moved on to the development of its theories of liability applicable to the facts of the case. See remarks of Judge Swan, dissenting in Perlman v. Feldmann, 219 F.2d 173, 179 (2d Cir. 1955), and suggesting a limited duty of sellers of control. The known irresponsibility of purchasers of control appears to have been a significant fact in Benson v. Braun, 141 N.Y.S.2d 286 (Sup. Ct.), aff'd, 286 App. Div. 1098, 145 N.Y.S.2d 711 (2d Dep't 1955) (on motion to dismiss for insufficiency of complaint). See note 184 infra.


169. 28 N.Y.S.2d at 653.

170. Taking the figures most favorable to the defendants, the court determined that the "asset value" of the shares would amount to six cents a share. An expert witness had testified that, taking all "speculative elements" into consideration, the shares had a fair value of 25 cents a share ($263,750 for 1,055,000 shares) with slightly in excess of three cents a share ($32,000) added for "control features" (the latter amount consisting of one year's salaries and brokerage commissions which the owner of the majority of the corporation's shares might obtain for himself). Another witness valued the shares at 30 cents a share plus 10 cents a share added for
and that they had been sold for $2 a share, the court concluded that
the excess amount had been paid for what it referred to variously as
"... immediate en masse resignations and immediate election of
the purchasers' nominees as successors," 171 the "... resignations
and election of successors," 172 and "... control ... " 173 The
sellers were obliged to account to the corporation for the excess. Thus
far, the court had imposed liability for "profits," a measure of recovery
not in issue in the Insuranshares case.

In the determination of the Gerdes defendants' liability for "loot-
ing" losses, the part played by the excessive price they received is un-
clear. Some of the court's language indicates that the excessive price
should have put the sellers on notice that loss was likely to result from
the sale of shares. However, in the referee's report on the extent of
the sellers' liability for looting losses, the point was made that the
sellers' liability was based on "... more than simple negligence." 174
The court apparently acquiesced in that point, for in its opinion con-
firming the referee's report, the court held that it was not necessary to
decide whether loss to the corporation had been foreseeable by the de-
fendants, since liability was based on the "added" element of an illegal
sale of corporate office.175 That language indicates that liability for
looting losses (and not merely for profits) arose from the application
of a rule of law relating to the obligations of corporate managers rather
than from a factual finding of negligence. Despite that language, the
possibility remains open that even the court which decided the Gerdes
case could have held the controlling shareholders liable for looting losses
even though the price received for their shares was merely their "actual"
value and not something in excess of that value. That court did not
reject a rule of liability based on a negligent failure to investigate the
purchaser; if the sellers had been put on notice that they were selling
their shares to persons who might reasonably be expected to loot the
corporation's treasury, it seems plausible to suppose that they would
have been held liable for those losses. For instance, in Insuranshares,
the excessiveness of the price was only one of a number of facts serving
to put the defendants on notice, and although proof of such notice might
be more difficult if that particular fact were not present, at least in
theory it has not been made a sine qua non on the issue of notice.

171. Id. at 658.
172. Ibid.
173. Id. at 661.
174. 30 N.Y.S.2d at 773.
175. Id. at 779.
Aside from the question of the proper basis for imposing liability on a controlling shareholder for losses which a sale of control may cause, the investment company cases invite speculation about the responsibility of a transferor of control for his "profits" in a case in which there is no depletion of corporate assets after the transfer or, if there is such depletion, there are no clear factual reasons for the transferor of control to have suspected that looting might occur. The doctrinal and factual complexities of the investment company cases make difficult an intelligent prediction of the results of such a transfer. There is a question which the Gerdes case suggests and which may arise in any case in which a director or officer has sold controlling shares and at the buyer's request has resigned his office and procured resignation of other directors and officers. If such a sale is made at a price which a court might find to be in excess of the "value" of the shares sold, considered as individual units, will the seller be required to account to the corporation for that excess even though the buyer does not appropriate assets when he acquires control? The opinion in the Gerdes case gives rise to an inference that in any sale of controlling shares, a selling director or officer will be held to account to the corporation for such excess if an integral part of the sale is the substitution of the buyer's nominees as managers of the corporation. However, this narrow issue was not presented to the court; its treatment of the excess in price received by the sellers cannot be divorced from the complex factual context in which the receipt of that excess occurred. The sale in that case was in fact followed by waste of corporate assets and was accompanied by facts putting the seller on notice that the possibility of waste was present. In the companion case of Ballantine v. Ferretti,176 in which the question was presented in a somewhat different factual and legal setting,177 the same court stated

176. 28 N.Y.S.2d 668 (Sup. Ct. 1941).

177. Two corporations were involved in the Ballantine case. Corporation A supplied "management" to Corporation B, an investment company owning a security portfolio. Two of the defendants owned all of the shares of A and had practical control of B through the management contract and by reason of the fact that one of the defendants was the president and a director of B. Upon sale of all of the shares of A, the majority of the officers and directors of both corporations resigned and the buyers' nominees were substituted. B's portfolio of securities was not stolen, and no complaint was made by that corporation. However, suit was brought against the sellers of A's stock by the trustee of an insolvent third corporation, Corporation C. The purchasers of A's shares had obtained the funds with which they made the purchase by looting the treasury of C. C's trustee traced those funds into the hands of the sellers of A's shares and claimed recovery on the ground that the funds had not yet passed to a "bona fide purchaser." Recovery was allowed, on the ground that the sellers had in fact sold control of B and had therefore engaged in an "illegal" transaction. Defendants were required to pay to the trustee of C that portion of the purchase price they had received for A's shares which the court found to be in excess of the "fair value" of those shares.
that such a sale was "illegal" even though it was not followed by looting. However, even in the \textit{Ballantine} case, the facts indicated to the sellers as plainly as in the \textit{Gerdes} and \textit{Insuranshares} cases that looting might reasonably have been anticipated.\footnote{178} Earlier New York cases upon which the court relied in the \textit{Gerdes} and \textit{Ballantine} cases do not supply satisfactory answers to the question whether, in a case in which looting of a corporate treasury does not figure as a strong possibility, a manager will be required to account for his "profit" when he sells controlling shares at an excessive price. One such case involved primarily a question of pleading,\footnote{179} while another involved a scheme whereby the president and director of an insurance company, for a price, delivered control of the company by procuring the resignations of the old board and appointing the nominees of the buyer.\footnote{180} In the latter case, no sale of stock was involved, and the court was not faced with the necessity of balancing those seemingly conflicting policies which arise from the division of the corporate institution into responsible managers and non-responsive shareholders;\footnote{181} furthermore, as

\footnote{178}28 N.Y.S.2d at 681.

\footnote{179}Bosworth v. Allen, 168 N.Y. 157, 61 N.E. 163 (1901). The \textit{Bosworth} case arose on demurrers specifying misjoinder of causes of action; the court held that there was no misjoinder of causes of action to recover the profits made by sellers of control and the damages sustained by the corporation as a result of the control sale. Plaintiff receiver had alleged that defendant managers and shareholders had conspired with purchasers of control "... whom they knew to be irresponsible and untrustworthy..." The opinion does not indicate what proof would substantiate the charge of conspiracy or of defendants' knowledge of the character of the buyers. By dictum, however, controlling persons who "sell out" by resigning are liable to account for their gain as well as for damages "naturally resulting" from their acts. 168 N.Y. at 166, 61 N.E. at 165.


\footnote{181}There has been a substantial body of litigation involving agreements to appoint officers and directors, the effect of which would commit directors to courses of conduct not necessarily in the best interests of the corporation. The courts have been presented primarily with problems relating to the \textit{enforceability} of such agreements (either by way of actions for damages or suits for specific performance). The concept of the "illegality" of the "sale of a corporate office" is grounded in large measure upon policies developed in those cases, although the problem of accountability for gain was not in issue. Agreements by directors, not entered into as a part of an agreement for the sale of shares between the parties, to elect or procure the election of other persons as officers or to pay specified salaries to officers, have been held unenforceable by either party. West v. Camden, 135 U.S. 507 (1890); Watkins v. Passannahnte, 114 N.Y.S.2d 488 (Sup. Ct. 1952); Lockley v. Robie, 276 App. Div. 291, 94 N.Y.S.2d 335 (4th Dep't 1950); Odman v. Oleson, 319 Mass. 24, 64 N.E.2d 439 (1946); Dubbs v. Kramer, 302 Pa. 455, 153 Atl. 733 (1931); cf. Kratzer v. Day, 12 F.2d 724 (9th Cir. 1926); Clark v. First Nat'l Bank, 219 Iowa 637, 259 N.W. 211 (1935); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 555 (1918); Jackson v. Hooper, 76 N.J. Eq. 592, 75 Atl. 568 (Ct. Err. & App. 1910); see Annot., 12 A.L.R. 1070 (1921). If all of the outstanding shareholders agree, the result may be otherwise. Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936); Cohen v. Wacht, 124 N.Y.S.2d 207 (Sup. Ct. 1953). See also Miller v. Vanderlip, 285 N.Y. 116, 33 N.E.2d 51 (1941) (no allegation that those who agreed to urge board to elect plaintiff as president and general manager were directors). The courts are not uniform in their treatment of agreements by which the \textit{corporation} is committed to employment of an officer.
in the Gerdes case, the sale of control was followed by insolvency attributable to the fact of the sale.\footnote{Compare Thielsen v. Blake, Moffit & Towne, 142 Ore. 59, 17 P.2d 560 (1932), with United Producers & Consumers Co-op. v. Heald, 225 F.2d 615 (9th Cir. 1955), and Realty Acceptance Corp. v. Montgomery, 51 F.2d 636 (3d Cir. 1930).}

If directors agree that they will resign their positions and procure the substitution of other persons as directors, not as a part of a contract for the sale of shares by the resigning directors, such an agreement has been held to be unenforceable. Forbes v. McDonald, 54 Cal. 98 (1880) (mining corporation); Reed v. Catlett, 228 Mo. App. 109, 68 S.W.2d 734 (1934) (mutual insurance company without capital stock); Sauerhering v. Rueping, 137 Wis. 407, 119 N.W. 184 (1909) (same); cf. Griffin v. Patterson, 183 Okla. 108, 80 P.2d 246 (1938). Even though the agreement to elect or procure the election of someone as an officer is part of an agreement to sell shares, if the shares sold are less than controlling shares the agreement is almost uniformly held unenforceable. Guernsey v. Cook, 120 Mass. 501 (1876); McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934); Fabre v. Donahue, 185 App. Div. 779 (2d Dep't 1918); Fennessy v. Ross, 90 Hun 298 (N.Y., 1st Dep't 1895), 5 App. Div. 342 (1st Dep't 1896); cf. Noel v. Drake, 28 Kan. 265 (1882); Fremont v. Stone, 42 Barb. 169 (N.Y. 1854). Again, the result may be otherwise if all of the outstanding shareholders have consented to the agreement. Hayden v. Beane, 293 Mass. 347, 199 N.E. 755 (1936).

When the agreement contemplates a sale of controlling shares, resignation of the sellers from directorships and offices and substitution of the buyer's nominees, some courts have held such an agreement enforceable between the parties. Henry L. Doherty & Co. v. Rice, 186 Fed. 204 (M.D. Ala. 1910); Barnes v. Brown, 80 N.Y. 527 (1880); cf. Renner v. Progressive Life Ins. Co., 193 Ark. 504, 101 S.W.2d 426 (1937) (vendors held all outstanding shares); Northern Central Ry. v. Walworth, 193 Pa. 207, 44 Atl. 253 (1899) (no mention of use of resignation process). A contrary result was reached in Horbach v. Coyle, 2 F.2d 702 (8th Cir. 1924) (contract included provision for secret bonus to resigning officers and directors who agreed to procure sale by other shareholders); cf. Carlisle v. Smith, 234 Fed. 759 (N.D. Ga. 1916); Brewer v. Stoddard, 309 Mich. 119, 14 N.W.2d 804 (1944). One argument interposed in favor of the enforceability of agreements for sale of controlling shares involving a substitution of directors and officers has been that the purchasers are merely assuming the full control which would be theirs at the next annual meeting. The writer believes that the enforceability, by the parties, of agreements for the sale of controlling shares (both those involving the resignation of officers and directors and those not involving the resignation process) may properly be considered against the background of the policies articulated in the text with respect to the accountability of controlling shareholders, in the looting cases and otherwise. If it is found to be desirable to restrain the making of personal profit from a control sale, accountability for gains is one sanction which may be imposed by the courts; refusal to enforce an executory agreement for such a sale may be another appropriate sanction.

182. Further difficult problems arise out of both the Insurershares and Gerdes cases with respect to the extent of the liability of the sellers of control for the losses of the corporation caused by the activities of the buyers. Whether viewed in terms of a duty to investigate the buyers, or as an absolute duty to account for consequences resulting from a sale of corporate offices, the question is presented whether these cases have any significance outside their own peculiar facts. If the buyers of corporate shares engage in less flamboyant tactics than the buyers in the investment company cases, will the sellers of control be liable for ensuing losses to the corporation? The varieties of corporate wastage are voluminous. Besides direct theft of the physical assets of the corporation, the incoming control group may, among other things, pay themselves excessive salaries, bind the corporation to burdensome management contracts, divert business from the corporation to themselves or to corporations in which they are interested, or pay excessive dividends. The new managers may simply be so incompetent that the corporation becomes insolvent. Logically, liability for such losses could be imposed upon control sellers under the negligence rule of the Insurershares case and even more clearly under the Gerdes rule that a sale of a corporate office creates liability to account for those losses proximately caused by the sale. Bosworth v. Allen, 168 N.Y. 157, 61 N.E. 163 (1901), by its dicta, indicated that sellers of control would be held liable for a variety of acts of
Whatever doubts may remain, from a reading of the Gerdes case, about the accountability of resigning directors who sell controlling shares at a profit in a non-looting situation, recent litigation in the New York courts indicates that sale of control to known irresponsible persons will ground an action for recovery of profits. In Benson v. Braun, a shareholder brought a combined individual and derivative action to compel accounting by sellers of controlling shares who resigned their offices and directorships in favor of buyers' nominees. Plaintiff alleged that the defendants' shares had been sold for a price far in excess of their value and requested accounting for that excess. It was also alleged that the principal buyers, who had been directors of the corporation, had previously looted the corporation and were involved in litigation with respect to their derelictions as directors, all of which defendants knew at the time of sale. The lower court's denial of a motion to dismiss the complaint for insufficiency was affirmed by the appellate division. As in the investment company cases, the theoretical basis for requiring accounting for profits is left unclear. Although the lower court relied heavily on defendants' alleged knowledge of the buyers' irresponsibility, the appellate division recited only the plaintiff's theory that the excess price was paid for the resignations, for the election of the purchasers' nominees as directors and for the immediate control of the corporation. Again, as was suggested in the discussion of the Gerdes case, the significance of the case must be apprised in the light of the factual context in which the sale of control was alleged to have occurred. To state that the defendants were held accountable because they sold control with knowledge that further looting was a possibility may be to define their liability in too limited terms: no further looting had been alleged and the lower court found plaintiff's allegation of knowledge of past looting sufficient. The known potentiality of loss to the corporation, even through unknown

mismanagement by buyers, including the payment of excessive salaries, unnecessary expenditures, wasteful contracts and corporate expenses incurred in cancelling such wasteful contracts. However, even the two investment company cases did not impose liability on the sellers as though they themselves were the converters of corporate property, and each one called an end to accountability at some point short of full accountability for every act of omission and commission performed by the buyers. 42 F. Supp. at 129; 30 N.Y.S.2d at 775.

In addition, if an act of wastage or mismanagement is sought to be attributed to the sellers, some limitation is probably inevitable if the court adopts a theory of negligence as the liability determinant. The ample evidence upon which the court in the Insuranshares case based its finding that loss of some kind was foreseeable makes that case less significant as a guide to future conduct where suspicions are less open on the record or mismanagement is more subtle. Compare Dale v. Thomas H. Temple Co., 186 Tenn. 69, 208 S.W.2d 344 (1948) (allegation of conspiracy; director selling control required to account to receiver of corporation for some losses caused by buyers but not for excessive salaries paid by buyers to themselves).

devices, by persons who had demonstrated a lack of regard for the welfare of the enterprise as a whole may be the measure of liability for profits which the court was applying in the Benson case.

Far from establishing that the bare fact of a sale of controlling shares at a price in excess of their value will at least subject the controlling shareholder to liability for profits, the investment company cases have not wholly succeeded in making the selling controlling shareholders responsible even when losses actually occur. Levy v. American Beverage Corp. underscored the thought expressed in those cases that an important factor in the imposition of liability on the sellers of control was the ease with which the assets could be transferred or converted into cash. A derivative suit was prosecuted against one who had been president and director of a corporation engaged in the liquor business and had sold the 53 per cent share interest he had controlled. Reversing the trial court, the appellate division held that the defendant was not required to account to the corporation either for a part of the price received for his shares or for losses resulting from the buyer's mismanagement and looting of the corporation. The lower court had required the defendant to account for both. Relying in part on the Insuranshares case, the trial court had characterized the transaction

184. As suggested, the corporation might suffer loss through further looting. Loss might result in other ways. Thus the new controlling group may mismanage the corporation in ways which do not reach the level of outright looting but which favor the new controlling group at the expense of other shareholders. Or, in a case such as Benson in which the buyers are former directors under fire for past wrongs to the corporation, they may now be in a position to control any non-derivative litigation which has previously been instituted by the corporation; if the statute of limitations has run against a corporate suit since the date of its institution, or if remaining shareholders would be barred from instituting a derivative suit by some rule of law, the new controlling group may successfully evade all liability to the corporation. As suggested in the text, it is unclear from the opinion of the appellate division how far the possibility of such losses underlay its decision; it cited McClure v. Law, 161 N.Y. 78, 55 N.E. 388 (1899) (a case in which insolvency resulted from the sale), Porter v. Healy, 244 Pa. 427, 91 Atl. 428 (1914) (a selling shareholders' suit) and Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955), discussed at length in the text at p. 809 infra. The failure of either the lower court or the appellate division to discuss specific foreseeable losses to the corporation may mean only that such matters are to be developed at trial. That the potentiality of loss resulting from sale to irresponsible persons may be less significant than was intimated in plaintiff's allegation is to some slight extent suggested by the failure of the courts to discuss those losses and by the citation to the Perlman case, in which the court took a much more sophisticated view of corporate loss than the looting cases had demonstrated theretofore.

185. 265 App. Div. 208, 38 N.Y.S.2d 517 (1st Dep't 1942), reversing Levy v. Feinberg, 29 N.Y.S.2d 550 (Sup. Ct. 1941). As in the Insuranshares and Gerdes cases, and unlike the Benson case, the corporation had suffered loss before suit was brought. Principal losses had been caused by the buyer's use of the assets of the corporation to pay for the shares purchased and by the merger of the corporation with an insolvent corporation owned by the buyer. In the Benson case the lower court distinguished the Levy case on several grounds, one of which was the alleged actual knowledge in the Benson case that the buyers of control were irresponsible. 141 N.Y.S.2d at 288-89.
as a sale of control rather than merely of shares because of the following facts: the defendant had received more than three times the market value of the shares; he had disregarded the character of the buyer and his means of paying for the shares; he had timed the sale to coincide with the annual meeting so that the old board could be replaced without the necessity of resignation; and he had kept the sale secret until it had been accomplished. The trial court concluded that, as a seller of control, the defendant should be held accountable because the circumstances had been sufficient to require an investigation to determine whether the transaction was in the best interests of the corporation.

The appellate division questioned the trial court's characterization of the defendant's status as that of a "fiduciary"; it also concluded that it could not accept the finding that the defendant had been on notice of possible looting and mismanagement. The Insuranshares case was distinguished. That case had involved an investment trust with assets consisting of readily saleable securities; the present case involved a mercantile corporation. In the Insuranshares case, the assets had been converted into cash before the sale of the shares, and the directors and officers had resigned; those facts were not present in the Levy case.\(^\text{186}\)

The fact alone that the seller of control had failed to discover that the buyer would loot the corporation was an insufficient basis for liability. If the court was saying that the seller of control is not a guarantor of the buyer's honesty in all cases, it is difficult to disagree with that position. Even under the Insuranshares rule, no need for investigation of the buyer's integrity is necessary unless the seller has reasonable cause to suspect that the buyer will misappropriate the corporation's assets. And although the court in the Gerdes case doctrinally rested liability for losses on the fact that the defendants had sold corporate offices and not on the fact that they could foresee loss to the corporation, the courts have not imposed an absolute liability for losses caused by buyers of control in cases where the facts have not indicated that losses are about to occur.

---

\(^{186}\) With respect to the latter distinguishing point, the fact that the sale was timed to coincide with the annual meeting of shareholders may have relieved the defendant from the necessity of resigning, but it did not prevent the buyer from acquiring control of the corporation. The buyer's ownership of a majority of the shares permitted him to elect his nominees as directors and officers almost immediately upon acquiring the defendant's shares. The minority knew at least that a new management had taken over, which had not been true in the Insuranshares case, and theoretically could have kept their eyes open for chicanery. However, as a practical matter, the minority is probably no better informed about the activities inside the corporation when the new management is elected in this fashion than when it is elected by the directors through the device of serial resignations.
The court's observations in the Levy case, that no fiduciary duty rests upon one who sells a majority of the corporation's shares, may have constituted a rejection of the basis on which the theory of negligence in the Insuransshares case was constructed. Therefore, its distinguishing the Insuransshares case on the facts may not be too significant. However, in the process of distinguishing the two cases with respect to the price received by the controlling shareholders, the New York court revealed a basic conception of the "value" of controlling shares which requires examination. The fact that the defendant in the Levy case had received more than three times the market value of his shares did not serve as a liability determinant either in itself or as a warning of the buyer's intentions. In this case the "liquidation" or book value of the shares was $4.31 a share; exchange prices had gone as low as one and one-eighth a share; the defendant had received $3.50 a share. The court's major basis for rejecting the receipt of an excess over market as a liability determinant does not seem satisfactory. In sum, the court's position was that "control might have lawful advantages." 188

There may be a popular belief that controlling shares do as a fact command a higher price per share than individual shares. That belief may detract from the significance of the receipt of an excessive price as an evidentiary item on the issue of the control seller's notice of prospective looting. But several questions arise from the New York court's view of the value of controlling shares, even if it be conceded that, in particular cases, there may be "lawful advantages" attaching

187. The court suggested, as its test of liability, that the seller of controlling shares could not be required to account to the corporation if he has acted in "common honesty." This test may be too lenient in a situation involving a virtual transfer of the corporate enterprise. This test is a familiar one in the law dealing with transfers of commercial paper. The question whether the status of a "holder in due course" should be accorded to one who has purchased a negotiable instrument honestly, although he has made the purchase in the face of suspicious circumstances, has at least doctrinally been answered in favor of the honest purchaser. Investigation of suspicious circumstances is no longer required. See Britton, Bills and Notes 407-15 (1943). A test of common honesty as the highest measure of obligation in such a commercial situation is no doubt dictated by the supposed necessities of keeping a body of commercial paper in a state of fluidity. It may be undesirable to discourage rapidity in the transfer of checks and drafts by erecting an obligation of inquiry by prospective purchasers. It is difficult to see the necessity for encouraging even a closely corresponding rapidity in a transaction involving a transfer of control of a corporation where there are minority shareholders and creditors whose interests require some real attention from those who control the enterprise.

188. 265 App. Div. at 218, 38 N.Y.S.2d at 526.

to a controlling block of shares. (1) Is it not relevant to question what those advantages may be, particularly in a case where the result of the purchase of control leaves an inference that the particular advantage paid for was a power to loot the corporation? 190 (2) Is it not relevant to determine whether the seller of control reasonably believed that the excess in price paid by the buyer was paid for specific lawful advantages? (3) As a minimum protection to non-controlling shareholders, should not the receipt of a price for controlling shares in excess of such lawful advantages at least call forth a duty of investigation of the buyer's financial responsibility and, possibly, his business reputation? (4) Who should bear the burden of proof with respect to the value of such lawful advantages? (5) Can those advantages be valued realistically, and by what standards? (6) If such advantages cannot be valued realistically, does not the proposition that controlling shares may lawfully be sold at a premium result in the abandonment of all inquiry into the relevance of the fact that a price has been paid for controlling shares far in excess of the price such shares could have commanded if sold in smaller blocks? The courts have found, on an ad hoc basis as related to specific cases, that the receipt of an extraordinarily high price for controlling shares may serve as an indication that the sale is fraught with risk to the corporation. In view of the fact that freedom to ask for and retain a high price for controlling shares may encourage controlling shareholders to abandon the corporation in a helpless condition and take the risk of subsequent looting, the court's generalized disposition of the price issue in the Levy case hardly seems to be a satisfactory solution to a difficult problem.

The court drew another distinction between the Insurans shares case and the Levy case which should not be a controlling factor in all cases. That is the distinction based on the character of the assets of the two corporations. One court, at least, has not chosen to limit recovery merely to those companies whose assets consist of negotiable securities. In Dale v. Thomas H. Temple Co.,191 the Tennessee court required the sellers of control of a corporation engaged in the business of distribution and sale of oil and gasoline to account to the corporation's receiver for the buyer's appropriation of assets. The seller had transferred majority shares for slightly in excess of $2.81 a share, although some of the shares had recently been acquired for $1 a share. The price for the majority shares was to be paid by deferred instal-

190. The court was not illuminating on this point. "For instance, if corporate control for the purpose of a merger, or some similar object, was desired by the purchasers for legitimate purposes, undoubtedly they would pay more for a controlling interest." 265 App. Div. at 218, 38 N.Y.S.2d at 521.
191. 186 Tenn. 69, 208 S.W.2d 344 (1948).
ments, the buyer thereby obtaining control before the full price was to be paid. The excessiveness of the price and the manner of its payment were facts which led the court to find that the seller expected the buyer to misappropriate corporate assets, despite the fact that the corporation was not a financial institution with substantial liquid assets.

Although isolated controlling factors are not readily distilled from the looting cases, the following observations appear to be warranted:

1. On the facts of the cases, if not always on their theory, a major consideration has been whether the seller of controlling shares had reason to suspect that the corporate assets would be used by the buyer either to pay for the purchased shares or for other personal purposes of the buyer.

2. Whether the seller of controlling shares had reason to suspect that the corporate assets would be so used by the buyer is basically a factual question. No single factor can be found to have been controlling in answering that question. Some relevant considerations may be:

(a) Whether the corporation's assets are liquid in character. Although great weight has been placed on the existence of this factor, it does not appear inevitable that liability should be limited to those cases in which practically all of the assets are in the form of negotiable securities. Concededly buyers of control may more easily accomplish their objective secretly and quickly if the assets are in that form. However, if the corporation in fact has sufficient liquid assets to tempt a buyer, whether or not the corporation has fixed assets as well, that fact in combination with others may well serve to put the seller on notice of possible wrongdoing. And if other facts sufficiently indicate that the buyer intends to dispose of assets for his own purposes (e.g., to pay for the purchased shares), the non-liquidity of the assets should be a matter of indifference.

(b) Whether the shares were sold at a price in excess of market value. Some courts have concluded that receipt of an amount in excess of the market value of individual shares does not serve to put sellers on notice of wrongdoing, on the theory that such excess may be properly attributable to legitimate control features. However, the courts have only casually considered what these legitimate features may be, and have not developed any precise standards by which their value may be determined. This may be the result of an unarticulated assumption by the courts that the plaintiff should prove the non-existence of such permissible elements or their lack of value. This assumption appears to be unwarranted. History has demonstrated that the payment
of an excessive price for shares may be motivated by the buyer's desire to acquire something other than the power to control the normal business operations of the corporation. Since the seller of control is in the best position to prevent the buyer's acquisition for such harmful purposes, he should at least bear the burden of showing that it reasonably appeared to him that the buyer was paying for "lawful advantages" necessitating the payment of such a price.

(c) Whether the buyer was permitted to obtain immediate access to the corporation's assets upon purchase of the shares. This factor should be considered in combination with the buyer's desire to substitute a new board of directors for the old board through resignation of the latter. The existence of this combination of facts should not be controlling on the question of the seller's liability. Despite the language in the cases with respect to the "sale of corporate offices," the possibility that a buyer might desire to obtain immediate control of a corporation in order to integrate its business operations immediately with another business renders his desire to obtain such immediate control subject to conflicting inferences. In combination with other facts (such as the existence of liquid assets and the receipt of an excessive price), the buyer's desire to obtain immediate control may leave the seller with the quite reasonable suspicion that the entire transaction will result in injury to the corporation. Without such other facts, the seller is left with a less clear inference of wrongdoing.

(d) Whether the seller and buyer insist upon secrecy in the consummation of the transaction. If the factors considered in (c) are found to be directed primarily toward preventing disclosure to the minority shareholders, the inference is strong that wrongdoing may result from the transaction.

(3) Courts have not always required the seller to account to the corporation for his profit. However, in those cases in which the seller has been required to account for looting losses, no court has refused to require an additional accounting for the "excessive" part of the purchase price when an issue has been made of it.\footnote{192. Compare Benson v. Braun, 286 App. Div. 1098, 145 N.Y.S.2d 711 (2d Dep't 1955), in which the court sustained a complaint requesting solely an accounting for profits.}

\footnote{193. Byrne v. Barrett, 268 N.Y. 199, 197 N.E. 217 (1935) ; Commonwealth Trust Co. Case, 331 Pa. 569, 1 A.2d 662 (1938) ; Caveney v. Caveney, 234 Wis. 637, 291 N.W. 818 (1940) ; RESTATEMENT, TRUSTS § 203 (1935) ; RESTATEMENT, AGENCY § 403 (1933).} The remedy of accounting for profits is a familiar device in the law, serving to prevent personal interest from interfering with the fulfillment of an obligation to look after the interests of others.\footnote{193. Byrne v. Barrett, 268 N.Y. 199, 197 N.E. 217 (1935) ; Commonwealth Trust Co. Case, 331 Pa. 569, 1 A.2d 662 (1938) ; Caveney v. Caveney, 234 Wis. 637, 291 N.W. 818 (1940) ; RESTATEMENT, TRUSTS § 203 (1935) ; RESTATEMENT, AGENCY § 403 (1933).} But even though the threat
of a loss of profits may not have succeeded in a particular case in preventing a faithless agent from engaging in personally profitable activity which causes loss to his principal, the wrongdoer is nevertheless required to disgorge those profits as well as respond in damages for the losses he has caused. Such a two-fold recovery from the seller of control appears to be similarly appropriate.

(4) The effort to find legal tools which will permit examination of a sale of controlling shares has required doctrinal manipulation, largely because of the traditional attitude toward the immunity of those engaging in share trading. Thus, if a seller of shares has been an officer or director, it has been held that he has violated a duty owed to the corporation in his managerial capacity. It has also been flatly stated that a transferor of control owes a fiduciary duty to the corporation; however, the cases in which that has been stated have involved shareholders who were either (a) directors or officers or (b) corporations whose appointees were directors or officers. The inference might therefore be drawn from the cases that only those who can be found to have violated or to have assisted in the violation of some recognized managerial duty may be held liable for loss to the corporation. The inference does not seem to be warranted or desirable. Straining to achieve such symmetry in corporate concepts ignores the basic issue in these cases. That issue is whether those who do in fact control the disposition of corporate assets have transferred that control under circumstances which should have put them on notice that loss would result to the corporation. Control, as a fact, can be found to reside in an individual shareholder or a group of shareholders even though they do not themselves technically occupy managerial positions. If, as a fact, the technical management of a corporation has declared its independence from the majority shareholders, perhaps liability may not be imposed upon the selling shareholder. Such freedom from liability would result from the fact that the majority shareholder does not control the corporation; it would not result from the fact that he does not technically occupy an office or a directorship. At least some of the looting cases have demonstrated that the courts are beginning to appreciate the fact that "control," as a factual matter, is superseding the traditional technical cleavage between managerial and shareholder functions.

194. RESTATEMENT, AGENCY § 407 (1933).
2. Against Controlling Shareholders When Sale Is Not Followed by Looting or Looting Is Not Anticipated

a. Liability Based on Diversion of Specific Opportunities

In the cases discussed in the previous section, controlling shares were sold under either of the following circumstances: (1) the sale was followed by looting and (2) even though no looting occurred, corporate loss was an anticipated risk. A sale may be accomplished which does not result in looting; if looting does take place, it may not have been reasonably anticipated by any of the pragmatic tests applied by the courts in the cases already examined. If a corporation is unable to attack a control sale on any of the bases suggested in those cases, is there nevertheless a reasonable basis for recognition of a cause of action in the corporation to recover some part of the seller's premium on his shares? One possible approach to this problem is through an examination of negotiations leading up to a sale of controlling shares when there has been no disclosure of those negotiations to other shareholders. Since a variety of negotiations may precede such a sale, the following cases are suggested for consideration:

Case E. Offer of Merger or Purchase of Assets. Buyer may approach D, who is either (1) an officer or director (who may or may not then own a controlling block of shares) or (2) an owner of a controlling block of shares (not an officer or director). Buyer may submit an offer to merge the corporation with another corporation or to purchase all of its assets. D may suggest that Buyer purchase a controlling block of shares. He may point out that this will involve a smaller expenditure by Buyer than a merger or sale of assets would entail. He may further suggest a price for the controlling shares which includes a premium over the price which Buyer would pay if he were to buy individual shares or small blocks of shares on the market.

Case F. Offer To Purchase All Outstanding Shares. Buyer may approach D, the person referred to in Case E, with an offer to purchase all of the outstanding shares of the corporation. D may suggest that Buyer purchase a controlling block of shares, for a lesser expenditure than a purchase of all of the shares would entail. He may also suggest a price which includes a premium over the market price of individual shares or small blocks of shares.

Case G. Offer To Purchase a Controlling Block of Shares. Buyer may approach D, the person referred to in Case E, with an offer to purchase only a controlling block of shares. Buyer
may know or believe that $D$ owns such a controlling block, or he may propose that such a block be accumulated for sale to him. $D$ may suggest a price which includes a premium over the market price of individual shares or small blocks of shares.

In each of the three cases posited, $D$ may sell a controlling block of shares which he then owns, or he may accumulate a controlling block in order to deliver such a block on the agreed terms.

The three cases may be examined initially on the hypothesis that $D$ is not solely a shareholder but is also an officer or director. The liability of one who is not simultaneously a controlling shareholder and a manager will be considered hereafter. The Seltzer case discussed in the introductory section to Part Two, throws light upon Case E. If a sale of controlling shares is followed by an immediate sale of all of the corporation's assets to Buyer, and a proportionate distribution of the proceeds of such a sale is made to the remaining shareholders, the Seltzer case would be a direct precedent for requiring an accounting by the sellers of control. In such a case, since the remaining shareholders no longer have any interest in the assets, the opportunity which might have been theirs (to sell the assets at a favorable price) has been irrevocably lost, and the controlling shareholders have appropriated a part of that favorable price. On the other hand, if the sale of controlling shares is not followed by a sale of the corporation's assets to Buyer, the Seltzer case is not so directly in point. The remaining shareholders have not irrevocably lost an interest in the assets. However, they have lost an opportunity for the corporation to sell the assets at that time at a favorable price. A similar opportunity may not arise again. To hold at least the directors and officers liable for having appropriated the benefit of an opportunity which was available to the corporation would be consonant with well-established managerial responsibilities.

Case F involves an offer to purchase all of the outstanding shares, which has been converted into a sale of controlling shares. If the

---

197. See pp. 805-06 infra.
198. Commonwealth Title Ins. & Trust Co. v. Seltzer, 227 Pa. 410, 76 Atl. 77 (1910); see text at p. 777 supra.
199. The observations made in the text with respect to a sale of control which is preceded by rejection of an offer to purchase all of the assets are equally applicable to a sale of control preceded by rejection of an offer of a merger. For this purpose, the analogy between a sale of assets and a merger is particularly close; each involves a change in the economics of the enterprise which may well increase the value of the shareholder's interest.
201. In Keely v. Black, 91 N.J. Eq. 520, 111 Atl. 22 (Ct. Err. & App. 1920), it was agreed that the president should acquire all of the outstanding shares or, if he was unable to accomplish that, then as many of the shares as he could acquire in excess of 31%.
director or officer making such a sale has not disclosed to the remaining shareholders that Buyer initially proposed to purchase their shares as well as his own, he has effectively foreclosed them either from an opportunity to sell their shares or from bargaining with Buyer.

A preliminary question arises whether a manager to whom a third party has presented an offer to purchase all of the corporation's outstanding shares will be subjected to a sanction by the courts solely for failing to communicate such an offer to the shareholders even though he does not make a favorable sale of his own shares. One court, at an earlier day, considered the problem only in passing upon another question and referred to a president's "... moral, if not his legal, duty to advise those interested of the terms of such proposition, so that they might accept or reject as they saw fit. Such a course was far more in consonance with a just conception of what he owed to the stockholders than a hiding of the proposition until he could secure terms for his own further retention in office, or an equivalent pecuniary consideration." 202 More modern conceptions of managerial responsibilities, which have been observed to be widening even in connection with share trading, may have moved to the point where the communication of such an offer falls within the enforceable duties of a corporate manager, although the fact that the manager has not received a discernible benefit from failing to communicate such an offer and the difficulty of finding a measure for his pecuniary liability may make a court hesitate to recognize the existence of such a duty. 203

However, not all of the problems posed in the preceding paragraph need be answered in order to consider Case F. In that case the manager has by hypothesis sold his own controlling shares. He is therefore foreclosed from arguing that he thought it would not be in the best interests of the corporation to transfer control to a group of irresponsible people, since he has in fact transferred control. His receipt of a premium for his shares is indicative of his use of the information for purely personal reasons and suggests an available measure of liability if a basis for imposition of liability may be found. Three bases, either independently relevant or to be considered in combination, may be suggested:

(1) The manager has appropriated an opportunity available to the shareholders at large. It has been suggested earlier in this article


203. Assuming that the offered price was in excess of the market price of the shares on the day the offer was made, the manager who failed to communicate the offer might be held liable to shareholders for the difference between those two prices. Questions which might arise are: (1) Should the manager's liability be greater if the
that an appropriate basis for recovery by one who sells his shares to a manager who in turn resells at a profit is the fact that the selling shareholder has been deprived of an opportunity to sell his shares, or to bargain for sale, at a favorable price. In Case F to permit the corporation, acting on behalf of the remaining shareholders, to recover some portion of the selling manager's profit would merely complete that picture. It may be argued that there are compelling differences between the case of the corporation suing on behalf of remaining shareholders and the case of selling shareholders suing because their shares were resold at a profit. A principal difference, however, is one relating to problems of proof rather than to substantive liability. Where a manager has purchased all of the outstanding shares in order to accumulate them for resale to a third party as in Case A, it is easier for the shareholders to prove that Buyer did in fact want to buy all of the shares. Where a manager has converted an offer for all of the outstanding shares into a sale only of controlling shares, as in Case F, it is more difficult to prove that Buyer did in fact initially propose a purchase of all the shares. That it may be difficult for the remaining shareholders (or the corporation on their behalf) to prove that the manager converted such an offer into a transaction profitable only to himself may suggest the advisability of shifting the burden of proof on that issue from the complainant to the manager. It should not suggest releasing the manager from liability. An additional difference between the two cases is the fact that the shareholder whose shares are resold by a manager loses irrevocably an opportunity to sell shares at a favorable price; the remaining shareholders have lost a specific opportunity but have not lost the possibility of similar opportunities in the future. A short answer to this may be that the manager should not be permitted to profit from a gamble that other opportunities will become available to the remaining shareholders at a later date.

(2) The manager has used “inside” information for his own benefit. However, the information is “inside” because it has come

to one who is a manager. Perhaps the seller of control may contend
that Buyer came to him not in his managerial capacity as such, but
because Buyer knew or believed that he owned a large block of shares.
Under such a state of facts, is the information that Buyer was willing
to purchase all of the shares "inside" or "outside" information? At-
ttempted solution of that problem, as suggested earlier in this article
in another context,205 may move into the realm of the metaphysical.
In addition, the argument that the defendant's liability depends on the
capacity in which he received the information assumes that a control-
ling shareholder is not in a position to receive "inside" information.
The facts of corporate life indicate that it is the pragmatic relationship
which the defendant bears to the corporation which is important, and
that no meaningful division can be made between managerial capacities
and controlling shareholder capacities on that issue.

(3) The manager would probably have acted in the best interests
of all of the shareholders by communicating Buyer's proposal to pur-
chase their shares, but failed to do so because of his own personal
interest.208 A prophylactic removal of a part of the profit from a sale
of controlling shares would remove the temptation to ignore the best
interests of the shareholders at large. The measurement of the extent
of the manager's liability is a collateral problem not necessarily related
to the question of substantive liability; the problem of measuring such
liability will be considered hereafter.207

Case G, involving negotiations only for sale of controlling shares,
is suggestive of the New York case of Stanton v. Schenck,208 decided
a decade before the investment company cases. In the Schenck case, a
block of shares allegedly constituting practical control209 of Loew's,
Inc., was sold to Fox Theatres Corporation. At a time when the widow
and other members of the family of the former president of the corpora-

205. See pp. 754-55 supra.
206. A sale of controlling shares by a manager may interfere with an un-
prejudiced exercise of his judgment with respect to a corporate matter of which such
sale is an integral part. Seagrave Corp. v. Mount, 212 F.2d 389 (6th Cir. 1954);
207. See pp. 817-20 infra.
208. 140 Misc. 621, 251 N.Y. Supp. 221 (Sup. Ct. 1931); see also Stanton v.
209. On August 31, 1928, 1,334,453 common shares were outstanding. Moody,
INDUSTRIALS 2464 (1929). Four hundred thousand shares were transferred in Feb-
uary, 1929. On August 31, 1929, 1,363,993 3/4 shares were outstanding. Moody,
INDUSTRIALS 1425 (1930). 1,341,946 3/4 shares were outstanding as of October 25,
1929, in addition to 150,000 voting preferred shares. 140 Misc. at 623, 251 N.Y. Supp.
at 223. The court did not make a finding, one way or the other, on the question
whether the block of 400,000 shares constituted practical control as alleged. It does
not appear unreasonable to assume that it did constitute such control. Cf. Moody,
INDUSTRIALS 2461 (1929).
tion owned a large block of shares, a broker approached the incumbent president with the request that the president suggest to the widow that she part with her shares. The widow agreed that she would make the sale if the buyer would take a block of 400,000 shares which would include those of herself and her family and those owned by certain officers, directors and other persons who had assisted her husband in building up the corporation. The agreed price per share was $125, of which $102.50 was to go to the sellers of shares. The balance was to be paid to three directors of the corporation (the president and two vice-presidents) as a bonus for work they had done with the widow's late husband. The broker then interested Fox Theatres in the purchase of this block of shares. Some shares were purchased in the market by the three directors to complete the formation of the block of 400,000 shares, and the sale was accomplished; the three directors made an alleged profit of approximately $9,200,000 from the transaction. A derivative suit was brought against the three directors to require them to account to the corporation for their profit. After trial, the complaint was dismissed.

It should be noted that the suit was brought to call the corporation's officers and directors to account; the widow, who was not an officer or director of the corporation although she had been the holder of a substantial block of the corporation's shares, was not made a party.

The plaintiffs relied in large measure on a theory of managerial accountability for waste, although the relief requested posed more clearly the question of the liability of managers to account for profit arising from a transfer of their shares as a part of the sale of a controlling block. The court was unable to find the customary liability determinants. (1) The corporation had lost nothing; there had been

210. The corporation's common shares, listed on the New York Stock Exchange, had reached a high of $77 during 1928 and $84.50 during 1929. Prices ranged between $50 and $60 "for a considerable period" during 1929. The questioned sale took place in 1929. (In 1930, the shares were quoted at $96.75 a share.) Defendants had received not only $102.50 per share (a price considerably above the market price in 1929) for the shares which they had personally owned but also, as a bonus, the difference ($22.50) between $102.50 and $125 for every share included in the block of 400,000 shares sold to Fox. The court referred to the "profit" made by the defendants as being approximately $9,200,000. This amount appears to represent principally the bonus of $22.50 per share on 400,000 shares. It does not appear whether the plaintiffs were asking for an accounting of any other "profit," such as the difference between the current market price of the corporation's shares and $102.50 allocated to each of the shares owned personally by the defendants and sold by them as a part of the block of 400,000 shares. 140 Misc. at 624-25, 251 N.Y. Supp. at 224-25.

211. Plaintiffs alleged that there had been a conspiracy between the defendant managers and Fox to acquire a controlling interest in the corporation for Fox, to wreck the corporation, to turn over the good will and assets of the corporation to Fox and to reduce the directors and officers to the status of dummies for Fox. These allegations were in addition to the allegation that defendants had conspired to secure a secret profit at the expense of the corporation and its shareholders. Id. at 627, 251 N.Y. Supp. at 227.
no waste; the net earnings of the corporation had increased subsequent to the sale; and there had been no change in the corporation's policy. (2) It had not been shown that a sale of outstanding shares to the buyer had deprived the corporation of a needed opportunity to raise new capital through the disposition of unissued shares. (3) The transaction had not involved corporate property; therefore the directors had not received a secret gift in connection with a "corporate transaction." It should also be noted that the defendants had not resigned from their positions with the corporation, so that it was not possible for the plaintiffs to base liability on a sale of corporate office.

The court considered the ultimate issue in the Schenck case to be "... whether or not a person who, because of his position as an officer and director of a corporation, is enabled to sell his shares of stock at a much larger price than the stock would bring in the open market, is bound to turn that profit back into the treasury of the corporation ... ." 212 The court analyzed the transaction as one in which the information about the possibility of a sale of the shares had come to the president because he was acquainted with the principal shareholder rather than because he occupied the office of president. This finding of fact could have disposed of the question as stated by the court. However, apparently without emphasis on the "capacity" in which the directors had received information about the possibility of a sale of shares, the court further considered whether directors should be required to account to the corporation for profit made from a sale of their shares above the current market price. The court stated that, absent "unfair dealings and conspiracy," accounting should not be required. It buttressed its statement with a strong dictum clearly exonerating not only directors but, by necessary implication, all sellers of "exceptionally large" blocks of shares without regard to whether they were also directors and officers. 213

It is clear that the court did not relieve the managers from liability merely because their own shares, being only a part of the block of shares sold, had not carried "practical control" of the corporation. 214

212. Id. at 629, 251 N.Y. Supp. at 229.

213. "No one will argue that the holder of a large block of the stock of a corporation would be under a duty to account for his profit to the corporation. As such holder he might be in a position to command a considerable premium above current prices in a favorable market. The advantage would be entirely his, for which he would in no way be compelled to respond to the corporation. If it is granted that a director may freely sell his own stock, it must follow that he may benefit from the advantage due to his holding of an exceptionally large block of stock. Possibly, evidence of unfair dealings and conspiracy, such as are charged in the complaint, might make a difference; but, in view of the failure of proof in that direction, we are relegated to the abstract principle as to the right of a director to sell his stock freely to the best advantage. This he may do." Id. at 633, 251 N.Y. Supp. at 233.

214. Only a portion of the 400,000 shares sold had been owned by the three directors prior to the consummation of the transaction. However, the court's reference
The plaintiffs had fairly posed the proposition that the 400,000 shares sold, of which the defendants' shares had been a part, did constitute controlling shares, and the court did not find against the plaintiffs on that point. In addition, much of the "profit" from the sale of this controlling block had been diverted into the defendants' hands. Had the plaintiffs sued all of the prior owners of the shares making up the block, seeking an accounting for profits and tracing those profits into the hands of the three directors, it is unlikely that the court could have rested exoneration merely on the ground that no single shareholder had sold sufficient shares to transfer control. If all of the prior owners had knowingly pooled their shares to make up a controlling block, it is doubtful that their cooperation could have been ignored. Even on that assumed state of facts, however, it is reasonable to suppose from the court's language that it would not have required an accounting of profits by shareholders cooperating to sell control. As to each such shareholder, in the court's words, "the advantage would be entirely his. . . ." 210

The reasonableness of the position of the court in the Schenck case and its application to Case G may be examined in the context of the foregoing discussion of Cases E and F. It cannot be said that the manager selling control has precluded other shareholders from benefiting from a proposed sale of the corporation's assets or of their own shares, in view of the fact that Buyer has made it clear from the outset that he was interested only in acquiring control and negotiated directly with the one who owned controlling shares or who acquired them from shareholders not complaining at this time. However, the facts concerning Buyer's negotiations are generally unknown to the remaining shareholders even after the transaction has been completed and after they have been informed that the sale has taken place. Presumably the seller of control will reveal only that Buyer wanted a specific block of shares and that he bought that block. The truth of the matter may be that Buyer offered initially to buy assets, or to merge, or to buy all of the outstanding shares.216 Inaccessibility of those facts to the remaining shareholders may make it almost impossible for them to substantiate a claim that the seller of control diverted to himself a

to the right of a director to "... benefit from the advantage due to his holding of an exceptionally large block of stock . . ." (see note 213 supra) suggests that the court was assuming that the defendants' responsibilities, if any, should be examined from the standpoint of their having had beneficial ownership of the entire block of shares.

215. See note 213 supra.

216. The facts are, of course; known to the buyer. Recognition of a "corporate" cause of action (which might benefit not only the remaining shareholders but also the buyer) causes problems. See pp. 821-30 infra.
transaction potentially profitable to all of the shareholders. Assuming that requiring the seller to account for receipt of a premium for his shares may be grounded on his diversion of such transactions, the minimum protection which can be afforded to remaining shareholders is to require the seller to account in all cases unless he can sustain the burden of proving that prior negotiations dealt only with controlling shares. The prospect of having to meet this burden may tend to prevent the diversion of offers potentially profitable to all of the shareholders and may further tend to encourage disclosure of the character of prior negotiations and thus prevent the diversion from taking place. Although the defendants in the Schenck case might have been able to sustain such a burden, it is clear that the court was not thinking in those terms, since the defendant did not offer any rebuttal to the plaintiffs' case. Since the prior negotiations, so far as they could be elicited by the plaintiffs, related only to controlling shares, the Schenck case should not be taken to represent even that court's reaction to a situation where such negotiations related to matters potentially profitable to all of the shareholders.

The foregoing discussion has been directed toward the problem of the accountability of a manager who is simultaneously a holder of controlling shares or who acquires power over controlling shares prior to their sale to a third party. If in any one of the three hypothetical cases, D is solely a holder of controlling shares and does not simultaneously occupy an office or directorship, the problem of the court's insistence upon the existence of a "fiduciary duty" becomes more acute. In such a case, it cannot conveniently be argued that the selling shareholder has violated any duty falling upon him because of his exercise of a managerial function. In examining the looting cases, it was noted that the Insuranshares case held that liability for looting losses resulted because some of the shareholders occupied a control position even though they did not technically hold office. The fact that the majority or substantial shareholder holds an important corporate office will make it easier to prove that he occupies a control position than if he exercises his control through the appointment and supervision of those who do hold office. If a seller of shares resigns from office and the buyer's nominees are substituted as officers and directors, that is strongly evidentiary of the fact that the seller occupied a control position. As observed in the Insuranshares case, the fact that a shareholder does not technically occupy a managerial posi-

217. Another basis for liability is suggested at p. 814 infra.
tion does not necessarily exonerate him from liabilities resulting from his abuse of that which is factually a position from which he can control corporate destinies.219 There may be serious problems of proof facing those who would assert that a transaction concerned control and not merely shares, arising from the fact that the seller was formally only a shareholder. Those problems of proof should not preclude recognition of the existence of responsibilities flowing from an assumption of power.

It is obvious that the courts will be more willing to impose responsibilities on shareholders who have sold control to persons who loot the corporation than on those who unfairly appropriate opportunities available to other shareholders. The question whether those responsibilities should be imposed should not depend upon the application of a negative, all-inclusive and uncritical doctrine of “no fiduciary duty.” It is not true that shareholders have been permitted unlimited latitude in the exercise of control. The Insuranshares case is demonstrative of that fact.220 In addition, the cases reveal that the courts have not invariably applied that negative doctrine in their development of the responsibilities of controlling shareholders in other contexts; there are increasing numbers of instances in which majority or other controlling shareholders have been subject to injunction, accounting, damages or other sanctions for the exercise of that control.221

219. In Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955), involving the liability of one who was president, director and controlling shareholder, the court stated: “In this case the violation of duty seems to be all the clearer because of this triple role in which Feldmann appears, though we are unwilling to say, and are not to be understood as saying, that we should accept a lesser obligation for any one of his roles alone.” Id. at 178.

220. In Mayflower Hotel Stockholders Protective Committee v. Mayflower Corp., 173 F.2d 416 (D.C. Cir. 1949), majority shares in the hotel company were sold to Hilton Hotels Corporation for $13 a share. The majority shares had been controlled by Donner Estates, Incorporated, who elected members of the board of directors of the hotel company. A derivative suit was brought against the former controlling shareholder, officers and directors of the hotel company and the buyer. The court held that a cause of action had been stated not only against the buyer and the officers and directors but also against the controlling shareholder. The complaint alleged, inter alia, that the controlling shareholder had (1) refused to pay dividends, so as to reduce the market value of the shares, and purchased shares at reduced prices, (2) conspired with the buyer to secure the hotel company for the buyer and to assist the latter to acquire hotel company shares at a manipulated price through false representations, and (3) wilfully and in pursuance of a conspiracy withheld from the board and the shareholders an offer for the hotel company at a realizable value of $18 per share and an offer for the controlling shares at $17.50 per share. The claims were found not substantiated at trial. Mayflower Hotel Stockholders Protective Committee v. Mayflower Corp., 193 F.2d 666 (D.C. Cir. 1951).

One further point must be noted with respect to the foregoing hypothetical cases. The focus of the discussion has been on loss and injury to remaining shareholders resulting from a sale of controlling shares and suggested bases of liability have been couched in those terms. From time to time, the courts have suggested that a "sale of a corporate office" will subject a seller of controlling shares to liability. It is true that the decided cases have demonstrated that if the buyer insists, as he usually will, the seller of shares may have the buyer's nominees substituted as directors and officers, by resigning such positions and appointing substitutes or by procuring resignations and substitutions by those who do hold such positions. However, whether the selling shareholders shall be required to account to the corporation for the premium received for controlling shares should not depend upon whether the sale has been accompanied by resignation of the old directors and officers and substitution of the buyer's nominees. Although resignations and substitutions commonly accompany sales of controlling shares,²²² the fact that they do take place should not be considered the sole determinant of the seller's liability, nor should the fact in itself that the seller has not resigned or procured resignations relieve him from liability. Such resignations may have some significance in the looting cases as an indication that the controlling shareholder knew or

²²² Cf. Oil Shares, Inc. v. Kahn, 94 F.2d 751 (3d Cir. 1938).
suspected that wastage was in the offing, and even in those cases the particular degree of significance should depend upon the existence of other facts as well.\textsuperscript{223} It has appeared that the courts have resorted to the "sale of a corporate office" concept mainly to establish a juridical basis (\textit{i.e.}, "fiduciary duty") for an examination of the transaction, a basis thought to be necessary because of the doctrinal difficulties caused by traditional rules that a shareholder may sell his shares, and a director may resign, whenever he pleases.\textsuperscript{224}

By hypothesis, Cases E, F and G do not not involve looting by the buyers or suspicion that it might occur. In cases not involving looting, the fact that directors and officers have resigned their positions is factually significant for two main reasons:

(a) Such resignations are probative of the fact that the shares which have been sold do constitute the medium of control of the corporation. To the extent that liability may be imposed on a seller of control because of unfair use of information acquired in connection with a control transaction, at least part of the complainant's cause of action is made out when it is shown that the resignation process has been followed.

(b) Such resignations are merely a part of the factual operational pattern of a sale of control; the use of this pattern will aid in the preservation of secrecy. If Buyer wants the corporate machinery to be immediately responsive to him and wishes the transfer to remain secret, it will be convenient for a substitution of directors and officers to be made through resort to the process of resignation and appointment of successors. Buyer's alternative is to call a special meeting of shareholders or to time the sale to coincide with the annual meeting,\textsuperscript{225} at which time he may or may not be able to elect a board, depending upon whether he has acquired a majority of shares or can effectively control the proxy machinery. Calling such a meeting may apprise the shareholders of the control transfer. If Buyer wishes to install a new board immediately upon procuring the shares, without resorting to the resignation process, notice of a meeting must necessarily be given before the transfer is effected; if the meeting is to be a special one, it is unlikely that the shareholders can be kept in the dark about the transfer. The process of resignation is therefore a device to avoid publicity of the transfer. Since nondisclosure of the transfer may be a


\textsuperscript{224} See note 181 supra.

significant element in the question of the liability of the seller of control, as developed in connection with Cases E, F and G, the fact that the resignation process has been followed is merely probative of secrecy.

Lest too much significance be accorded the use of the resignation process, it should be noted that it is neither a factual *sine qua non* of secrecy nor conclusive proof that a transfer was secretly accomplished. On the one hand, it is possible for a secret transfer to be made without resort to the resignation process, by timing the sale to coincide with an annual meeting. On the other hand, shareholders might be fully informed that a transfer of control is to take place and that the old board will resign in favor of Buyer's nominees. Therefore, the fact that the resignation process has taken place should not of itself be a liability determinant.

However, it would be desirable to forestall use of such a process, since it may be abused so easily. This could be accomplished by repeal of those provisions of the general incorporation statutes which indiscriminately permit directors to fill vacancies and by substitution of provisions substantially comparable to those adopted in the Investment Company Act of 1940.228

b. The Development of New Bases of Liability

In the previous discussion it was concluded that a controlling shareholder's failure to disclose to remaining shareholders the character of prior negotiations and his diversion of offers potentially profitable to the corporation may serve as plausible bases for accountability to the corporation. In the discussion of Case G, it was developed that so long as accountability is based on such nondisclosure and diversion of offers, a sale of controlling shares would not necessarily result in accountability, at least if the seller could sustain a burden of proof that prior negotiations had been confined to a sale only of controlling shares. The recent case of *Perlman v. Feldmann*,227 although factually involving a secret sale of control preceded by a rejection of an offer of merger, was decided on a basis which did not emphasize either of those elements. The rationale of the court's opinion invites speculation about future judicial reaction to sales of controlling interests.

226. See note 163 supra.

Feldmann was the chairman of the board of directors and president of Newport Steel Corporation, a manufacturer of sheet steel. Through members of his family and personal corporations, he owned or controlled one-third of the outstanding shares of the corporation; through such shareholding he exercised practical working control of the corporation. In August, 1950, the corporation's shares had a book value of $17.03 a share; individual shares had been traded on the over-the-counter market at prices not in excess of $12 a share. Wilport Corporation was formed by users of steel for the specific purpose of acquiring the controlling shares in Newport. After negotiations with Feldmann, Wilport agreed to buy his shares for $20 a share. Feldmann's shares, plus shares of friends and associates, were sold to Wilport at the agreed price, Wilport acquiring 37 per cent of Newport's shares in the transaction. To complete the transfer of the shares and the attendant control of the corporation, Feldmann resigned from the board of directors and procured the resignations of the remaining members; Wilport's nominees were elected to fill their positions. A derivative action, in which Feldmann was the principal defendant, was brought at the instance of certain of the remaining shareholders to require accounting for gains resulting from the transaction.

Although Feldmann had previously rejected an offer of a merger of the corporation,\(^\text{228}\) and although the plaintiffs asserted that the transfer of control had been effected with secrecy, plaintiffs' main contention was that Feldmann, as an officer, director and controlling shareholder of Newport, owed a fiduciary duty to the corporation which he had violated by selling a "corporate asset" for his personal profit. The existence of the "corporate asset" was shown to have arisen from a peculiar market demand for Newport's product. During the Korean War steel was in short supply. Like other steel companies, Newport was unable to fill all demands for steel and was therefore able to allocate its steel production in a manner favorable to itself. Instead of raising steel prices, Newport used its market position to obtain interest-free advances from prospective customers in exchange for firm commitments by Newport with respect to future production. The advances were used for capital developments which Newport needed. Plaintiffs claimed that Feldmann had sold a power to allocate steel in a tight market, that such a power was exercisable through the corporation's board of directors and that it was therefore a "corporate asset" for the sale of which Feldmann and his associates should account.

\(^{228}\) Compare Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), and the discussion of Case E in the text at p. 798 supra.
to the corporation. Plaintiffs were unable to show that the sale had resulted in the corporation's being operated less profitably after the sale.

The district court concluded that all that Feldmann had sold were powers inseparably attaching to ownership of a controlling block of shares and that they constituted factors of value attaching to the control block which might be realized by him on its sale. It also found that $20 per share was the fair value of the control block of shares sold by Feldmann.

On appeal to the Second Circuit, the district court's judgment for defendants was reversed in an opinion by Judge Clark, and the case was remanded. According to the court of appeals, Feldmann had violated a fiduciary duty which he owed as officer, director and controlling shareholder; he should account for that part of the price he had received for his shares which was attributable to his sale of the power to control allocation of the corporate product. The court further directed that the accounting be made directly to the minority shareholders. The district court was required to make a determination of "... the value of defendants' stock without the appurtenant control over the corporation's output of steel," the burden of proof on this issue to rest with the defendants.

The court did not describe Feldmann's control of the corporation as a "corporate asset" in itself. It referred to the "corporate opportunities" available to Newport through its exercise of the power to allocate its product: the opportunity to secure interest-free advances and the opportunity to build up patronage in anticipation of the day when steel would be more abundant in supply. Those opportunities had been misappropriated or siphoned off by the defendants. To some extent the result may have been foreshadowed by the Seltzer case in which the defendants therein had masked a sale of all of the assets with a sale

230. The district court stated, in connection with that finding of fact: "What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show." Id. at 179.
231. Judge Swan dissented from this opinion. 219 F.2d at 178.
232. See note 219 infra. The court relied primarily upon Pepper v. Litton, 308 U.S. 295 (1939), and Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919), as establishing Feldmann's fiduciary relationship to the corporation as director and dominant shareholder. Although the court found no cases directly on point in Indiana, the state of Newport's incorporation, reference was made to one Indiana case for a statement of the "... close scrutiny to which Indiana subjects the conduct of fiduciaries where personal benefit may stand in the way of fulfillment of trust obligations." Schemmel v. Hill, 91 Ind. App. 373, 169 N.E. 678 (1930) (rescission of sale of real estate, for more than it was worth, to insolvent bank by one who was a director and vice president).
233. Commonwealth Title Ins. & Trust Co. v. Seltzer, 227 Pa. 410, 76 Atl. 77 (1910), discussed in text at pp. 777-79 supra. For reference to control as a "corporate asset" see BERLE & MEANS, op. cit. supra note 1, at 244.
of shares in order to obtain personal benefit. But the Perlman case did not involve an offer by a third party to buy assets or a diversion of such an offer into a sale of shares. The power to allocate the product of Newport's facilities could indeed have been transferred by a sale of all of those facilities, by a merger or consolidation or by a sale of all of the shares. The consideration received in such a transaction would have belonged proportionately to all of the shareholders. But in the Perlman case, it was held that the benefit of a transfer of that power could not be appropriated exclusively by a controlling shareholder through the device of a sale of his own shares, even though he had not diverted the buyer from a different type of transaction which would automatically have benefited all the shareholders. The considerations underlying the court's decision appear to be different from those requiring accounting in the hypothetical Cases E and F, in which diversion of potentially profitable asset or share transactions was involved.

In one sense, the result of the Perlman case grows out of the philosophy underlying the looting cases. The remedy of a recovery of profits is not inappropriate even though the corporation has not suffered loss as a result of a control sale. If the seller of control should reasonably have anticipated that the buyer would use control in such a way as to make the corporation's operations unprofitable and if the purchasers did cause such loss, the seller could be required to respond not only in damages but also to account for his gains. There is no reason why the corporation, or shareholders suing in its behalf, should be obliged to sue both for damages and profits: a waiver of damages should not preclude an action to require an accounting. Furthermore, if the holder of control sells to persons who reasonably may be expected to cause harm to the corporation, it is doubtful that the seller should be relieved from liability to account solely on the ground that the anticipated loss did not occur; accountability for profits is required as a prophylaxis to prevent temptation. In the Perlman case, however, there was neither loss in the sense that the corporation was operated less profitably after the sale than before nor anticipation of such loss. Instead, the court demonstrated a much more sophisticated approach than the looting cases demanded: the "loss" which the corporation suffered was a failure to realize gains which might possibly arise from its exercise of certain opportunities. Not only did that "loss" result, but it was easily anticipated, since the defendants must have known that the purchasers, being themselves users of steel

in a tight supply market, would probably not allocate the corporation's product as it had been allocated before the purchasers acquired control.

This view of the *Perlman* case may be read as suggesting that a controlling shareholder, even one holding a majority of the shares, may not with impunity make basic changes in corporate policy. It may be asked whether Feldmann would have been subjected to liability if he had not sold his shares and had simply procured the corporation's abandonment of its policy of allocating steel to obtain interest-free advances. That result is not a necessary corollary of the *Perlman* case or the fundamental basis on which it rests. At most, the law would require only that those in control of the corporation exercise an informed and honest business judgment in making such a basic policy change. Failing that exercise of due care, the law would impose liability for resulting losses as those losses are traditionally defined. Presumably, in the event the purchaser of controlling shares were to make such basic changes in policy, the corporation's redress would again be by way of a cause of action for damages if they could be shown.236

The looting cases established that the controlling shareholder was responsible for policy judgments of a flagrantly outrageous sort even though they were formally made by the new controlling shareholder; in one sense, a decision to transfer control to a group which might loot the corporation is itself a policy judgment by the controlling shareholder for which he is responsible if losses occur. By permitting a recovery of profits in the looting cases, the courts introduced the idea that the incentive to making that kind of policy judgment should be removed, for prophylactic purposes and whether or not loss has resulted. *Perlman* underscores the idea that the remaining shareholders are inadequately protected if their only remedy is a suit for losses resulting from the policy change. Shareholders are subject to enough risks from the normal operation of the corporation's business by persons other than themselves. A policy change, even though honestly and hopefully made, may result in loss simply because it is not wise or the winds of a competitive economy shift and blow cold; that loss is not necessarily actionable. Even if a policy change results in actionable loss, the remaining shareholders may find that the expense of litigation and the financial inadequacy of the defendants make the loss permanent. *Perlman* holds that there will not be added, to those inevitable risks, the risk that policy changes will be dictated not so

236. Thus it is recognized that the courts do afford some measure of protection to non-controlling shareholders, by way of corporate actions against management for flagrantly unwise or dishonest policy decisions and that some remedies are available to remaining shareholders against the new management which steps in after a transfer of control.
much by the controlling shareholder's honest business judgment that the corporation's earnings and assets will grow but by his decision to take a personal benefit at the same time that he removes himself from an interested position in the corporation.

The Perlman case did not proceed on the basis that every seller of controlling shares shall be required to account for some portion of his purchase price. The theory of liability was more narrowly oriented. The court spoke in terms indicating an intention to protect specific opportunities or advantages and it used language to limit the implications to be drawn from its opinion. But the technique of isolating specific opportunities suggests the direction of the growth of the law when only controlling shares are bargained for and sold. Springing from the Perlman case, the argument may now run that every corporation possesses opportunities beyond its book assets, opportunities attributable to its competitive position, contracts for supplying raw materials, commitments for distribution of its product, customer lists, latent productive capacity, an imaginative management or a host of other matters which might be exploited for the benefit of its present shareholders by its present management. The argument would then proceed that a sale of control which carries with it normal corporate powers also carries with it the risk that those powers may not be used to exploit those opportunities and advantages and that, therefore, the seller of control should account to the corporation for transferring powers in the face of the risk that the corporation's possible gains may not be realized. The court in the Perlman case emphasized that it is the possibility of gain which is important, not its inevitability. The way, therefore, appears to be open in future control sales for the remaining shareholders to identify particular opportunities which the sale might jeopardize and to seek accounting from the controlling shareholder who created that jeopardy. The result may eventually be a frank recognition that, since each control sale involves one or more of such opportunities, the basic liability determinant is the sale of control itself and not some collateral opportunity.

Three restraining factors on the eventual express recognition of such a broad rule of accountability may be suggested. First, the courts

237. "We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product." 219 F.2d at 178.

238. "... [T]he responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it." Id. at 176.

239. "Only if defendants had been able to negate completely any possibility of gain by Newport could they have prevailed." Id. at 177.
may hesitate to require an accounting unless the risk that the opportunity would be passed over by the buyer of control was a practical certainty, as it was in the *Perlman* case, rather than just a possibility.\(^{240}\) Second, if the liability determinant is no longer the jeopardizing of any specific opportunity, there may be a doubt as to the appropriate liability determinant. If it is merely the fact that control was sold, for what shall the seller account? The *Perlman* court did not suggest that a sale at the fair value of the defendants' shares considered as individual units rather than as a control block would require an accounting; by its requirement that the defendants show the value of their shares shorn of the power to allocate steel, the court made it quite clear that the presence of the misappropriated opportunity was the essential element in determining their liability. It may be argued that the liability determinant should be the receipt of a "premium" for controlling shares. In such an event, it may be difficult to determine whether shares have been sold at a price in excess of their "intrinsic" or "fair" value if there is no active market. To make the amount of a premium the *measure* of the controlling shareholder's liability does not seem inappropriate if that liability is once established through independent facts; to make it also the determining factor on the *existence* of liability may be difficult except in those cases where the price paid is clearly unrelated to the fair value of the shares. In legal theory, therefore, the cases will probably proceed in terms of the misappropriation of specific opportunities. In practice, knowledge on the part of controlling shareholders that it will be relatively simple for a complainant to identify such opportunities may serve as a pragmatic restraint on their sale of controlling shares at very much above a reasonable approximation of their current market price.

Third, the rule of the *Perlman* case should be extended to other control sales, irrespective of a showing that specific opportunities have been misappropriated, only if there are alternatives available to the controlling shareholder other than the making of the sale at the offered price. Those alternatives were not discussed by the court in the *Perlman* case, and its impact on practice in control sales is to that extent unclear. If faced with an offer for controlling shares at a price in excess of the current market, the control seller may do one or the other of the following:

1. He may refuse to sell controlling shares as a block under any circumstances.

\(^{240}\) The power to allocate production had been used in the past to acquire interest-free advances from those who bought the corporation's product. Since the purchasers of control could now allocate steel to themselves without making such advances, the prior source of capital was cut off by the sale of control.
(2) He may refuse to sell controlling shares at the offered price, but sell at the current market price.

(3) He may refuse to sell at the offered price unless the buyer makes an offer to the other shareholders to purchase their shares at the same price.\textsuperscript{241}

To force the controlling shareholder into any one of those positions by a rule of accountability is admittedly to restrain his free alienation of his shares. If forced into the first alternative, the controlling shareholder may be unable to dispose of all of his shares even though he may want to sell them at the time in question just to get out of the corporate picture; if there is no market except for control he may be obliged to hold on to his shares until he can dispose of them in smaller blocks from time to time as a market develops. Of course, the absence of a market is a risk which all the other shareholders are

\textsuperscript{241} If the buyer refuses to make the offer suggested in the third alternative, the controlling shareholder may, of course, be forced back to one or the other of the first two alternatives.

Two further alternatives may be suggested. (a) The holder of control may refuse to sell his controlling shares as a block but sell a proportionate part of them. Thus if control is exercised through a 40% ownership of shares, the holder of control may decline the buyer's offer to purchase all of those shares, but may agree to sell 40% of the shares he owns on the condition that the buyer offer to buy, at the same price, 40% of the shares owned by each of the other holders of outstanding shares. This alternative is probably unworkable. In the first place, the buyer may refuse to proceed on this basis, because of the possibility that other shareholders may be unwilling to sell the necessary percentage of shares; the buyer would therefore not be assured of acquiring the desired control. In the second place, the buyer may be less inclined to purchase control if there is the likelihood of the former controlling shareholder's remaining in possession of a substantial block of minority shares. However, if the buyer does accept this alternative and succeeds in acquiring control through the purchase of the desired percentage of shares, there is the further question whether the former controlling shareholder, even then, should be relieved from liability to account for the premium he has received on his shares. It is doubtful that the courts would require such accountability. The former controlling shareholder has not in fact transferred control or acted in concert with other shareholders to produce an aggregation of controlling shares in the buyer's hands. The independent judgment of other shareholders was necessary to that end, and although shares owned by the former controlling shareholder contributed more than those of any other shareholder to accomplishing the buyer's purposes, it could be argued that the shareholders whose sales were latest in time were the ones who factually placed control in the buyer's hands. Shareholders have traditionally assumed the risk that an outsider will accumulate control from scattered shareholders; in substance that is what is being done in the alternative suggested here. The rule of accountability seen developing from the \textit{Perlman} case is designed only to protect shareholders from the more serious risk of having that control shifted immediately and as a block from one person or concerted group which has previously assumed to chart the corporation's course and now decides to abandon it in favor of a personal profit. (b) The holder of control may refuse to sell his controlling shares to a particular purchaser but nevertheless sell to another purchaser. If the rule of accountability developed in the \textit{Perlman} case is designed to cover only that case in which it is known that specific corporate opportunities will be abandoned, resort to this alternative may relieve the control seller from liability. If, as the writer believes, the rule is reasonably capable of extension to almost all cases of control sales because of the risk that any number of such opportunities will be abandoned, the alternative may be more theoretical than practical.
taking, and there does not appear to be any special reason why a controlling shareholder should be protected from that risk. If faced with the second alternative, the controlling shareholder will at least not be transferring his control under the persuasive influence of a premium price and to that extent the remaining shareholders have some protection. But, along with the first alternative, that course of action makes a controlling shareholder forego a favorable opportunity to benefit from a prospective buyer's desire to pay a high price for his shares. No particular reason appears for giving a buyer the benefit of control at a bargain purchase. The third alternative would meet the objections which have been made to the first two: the controlling shareholder is not prohibited from disposing of his shares as a block, he is enabled to benefit from the buyer's desire to acquire control of the corporation, and the buyer is not put in a position to acquire shares by a bargain purchase. The benefit of this alternative is to give the remaining shareholders an opportunity to decide for themselves whether they will take the risks of new management or get a favorable price for their shares. Controlling shareholders who have resorted to this alternative have found sympathetic reception in the courts; they have been freed from an obligation to account for a premium received for their shares when they have insisted on an even-handed offer to all shareholders.242

The rule of accountability laid down in the Perlman case thus encourages communication with fellow-shareholders on the question of the advisability of making fundamental shifts in the operation of the corporation's business.

c. Measure of Liability

A major problem in the administration of a broad rule of accountability to which the Perlman case may lead was posed even in

242. Mayflower Hotel Stockholders Protective Committee v. Mayflower Hotel Corp., 193 F.2d 666 (D.C. Cir. 1951) (see note 220 supra). Determination of the time when such an offer should be made raises a separate problem. In the Mayflower case, the purchaser of control made an offer to all of the shareholders to purchase their shares at the same price paid for controlling shares; the offer was made after control had been transferred. The court held that plaintiffs had no claim based on the fact that notice of the transfer had not been given before the transfer had been accomplished. "Nevertheless the sale must be shown to have been fair, free of secret or undisclosed arrangements as to price or other considerations different from the terms subsequently made known to all stockholders, and entirely in good faith." Id. at 670. The offer should be made reasonably contemporaneously if the seller of control is to be relieved from liability to account for his gain. As the writer has indicated in the text, a seller of control should be relieved from that liability if he has given remaining shareholders an opportunity to choose whether or not they will take the risk of new management. They are not given a meaningful choice unless the offer is made to all shareholders either before control is transferred or practically simultaneously with the transfer. If the offer is not made until some time after control has been transferred, then whether or not the control transfer has worked advantageously to the corporation, the remaining shareholders have been subjected in the interim to a risk from which the rule of accountability for gain is designed to protect them.
the limited situation presented there. That problem involves the determination of the amount of the gain for which the seller of control must account and is focused primarily on the price for which controlling shares are sold. Many sellers of such shares have proceeded on the assumption that controlling shares properly command a price in excess of the aggregate value of the individual shares sold; thus the seller of control may argue that even if his liability to account depends upon valuation of his shares shorn of the power to control allocation of the corporation's product or shorn of some other corporate power, his shares nevertheless had a value in excess of the aggregate value of the individual shares making up the block. The assumption that shares have a legitimate "control" value has been accepted by some courts without examination into whether the excess which may have been received is commensurate with value reasonably to be attributed to the shares by reason of the fact that they carry control. At least one court has attributed specific value to the control element adhering to majority shares, although that value was found to be far less than the premium received by the seller of control over the value of his shares considered as individual units. Whether a seller of controlling shares shall account for all of the premium in price over the market value or other fair value of shares considered as individual units or only for some part of that excess is the question to be considered. It is clear from the Perlman case that he will not, in certain circumstances, be relieved from accounting for at least some part of that premium.

So long as the courts accept the limited proposition that accountability depends upon the sale of a "corporate power" and that only certain "corporate powers" fall within the ambit of the Perlman case, a seller of controlling shares may argue that all or a part of the price he has received for his shares may appropriately be allocated to legitimate control advantages. The utility of this argument will depend upon the circumstances under which it is presented. Two situations may be considered.

(a) A seller of controlling shares who receives a price which includes a premium over the market value of the shares as individual units may reasonably anticipate that some minority shareholder may move the corporation to call him to account for some part of his premium. The subsequent disclosure of such a premium may encourage


a search for a "corporate power" by a minority shareholder who may plausibly argue that no excess over market price will ever be paid unless the buyer wants to acquire some peculiar power not obtainable by the purchase of shares unless they carry control. The consequent pressure on the courts to segregate control advantages which may lawfully be sold from those which may not may result either in the confinement of the Perlman case to its peculiar facts or, as suggested above, in the adoption of a broader rule of accountability.

(b) If a court determines that accountability is required because a peculiar "corporate power" has been improperly sold, the defendant may seek to reduce the amount for which he shall be required to account by arguing that his sale of control involved not only sale of that "corporate power" but the sale of some of the "lawful advantages" of control as well. That argument should not be recognized. Adequate standards of valuation do not exist for segregating the price paid for controlling shares into (i) the part which is paid for that aspect of all shares which may variously be called their "actual," "intrinsic," "investment" or "market" value, (ii) that part which is paid for "lawful


246. The determination of the amount which the seller of control should be permitted to retain requires some verbal description of that amount and the establishment of standards by which that verbal description is to be fulfilled. The "fair value" of defendant's shares may be suggested as a standard. (Cf. Young v. Higbee Co., 324 U.S. 204, 208 (1945).) It is an adequate statement of the problem although, as such, somewhat tautological. In a normal transaction of purchase and sale, the concurrence of buyer and seller would be a sufficient standard of valuation. But in the control sale cases, when the holder of controlling shares has not procured the invitation of all other shareholders to participate in the "value" established by the purchaser, the "value" so established is inappropriate by hypothesis. Therefore it is necessary to resort to some artificial measure to determine a figure which will "fairly" compensate the seller of control for having transferred his shares in the corporation. To characterize that figure as the "value" of his shares does not aid in solution. It may be suggested that "value" is a word of many meanings precisely because in many contexts it serves only as a description of a price or figure which is "fair" to the parties under the circumstances; "fair value," therefore, merely describes the result to be reached. A similar problem is encountered in the determination of the "value" of a dissenter's shares in connection with a merger or sale of assets. In such cases also, there has been difficulty in arriving at an appropriate term describing the amount which will fairly compensate the dissenter. See, e.g., N.Y. Stock Corp. Law § 21(3) ("value"); Pa. Stat. Ann. tit. 15, § 2852-908(B) (Purdon Supp. 1954) ("fair value"); Va. Code Ann. § 13-47 (Supp. 1954); id. § 13-85 (1950) ("fair cash value"); Ky. Rev. Stat. §§ 271.415(4), 271.490 (1953) ("fair market value"); N.M. Stat. Ann. § 51-11-5 (1953) ("full market value"); Ala. Code Ann. tit. 10, § 100 (1940) ("market value").

Assuming that the problem may be described as the search for a "fair" amount or for "fair value," the standards to be applied in determining that "value" may be examined. One standard is rejected in the text, i.e., the valuation of "lawful" control features. In the writer's opinion, the "fair value" of the controlling shareholder's shares, for purposes of requiring an accounting in control sales cases, should be that figure which most closely approximates what a willing buyer would have paid a willing seller for individual or non-controlling, small blocks of shares in that corporation at the time of the sale, assuming that no more than normal changes in management policy were anticipated. Thus if the shares are actively traded on an
advantages" and (iii) that part which is paid for "unlawful advantages." Conceivably a control seller might search until he has found and valued a sufficient number of "lawful advantages" to consume the entire premium paid for his shares. By hypothesis, however, the court has found that the reason the buyer paid that premium was to induce a sale of controlling shares in order to acquire advantages which belonged to the corporation and were therefore not a proper subject of private sale. Requiring the seller of control to account is a remedy which does not appear to be designed to compensate the corporation for the loss of the power sold; its purpose is basically prophylactic. The fund from which the seller of control should give his accounting is that amount which he has received by reason of the fact that he has sold not merely shares but control. If the prophylactic nature of the remedy is to be preserved, he should not be permitted to reduce that fund by showing the value of hypothetical legitimate advantages which might have induced the buyer to pay a premium for control but which did not in fact materially affect the bargaining between the parties.

exchange or there is otherwise an active market among buyers and sellers informed of the corporation's conditions and prospects (although not informed of the contemplated control sale) prices current in that market should serve as the standard of "fair value." Market prices may more appropriately be used as a standard in control sale cases than in a dissenters' proceeding on a merger or sale of assets, since in the latter case market prices may be affected by the proposed merger or sale. It may appear that market prices have been manipulated by the controlling shareholder (as by an unwarranted declaration of dividends) who has sought to raise them in anticipation of a control sale, or that there is no active market. In either event standards of valuation should be based on capitalization of past earnings and earnings which could reasonably have been expected had the control sale not taken place. If any process of valuing "assets," as distinguished from valuing the going concern, should reveal a higher "value" than is obtainable by earnings capitalization, that "value" should be rejected; if the present management has been incapable of employing the corporation's assets to the full extent of their earning capacity, it should be inappropriate to permit that management to benefit from its inefficiency at the same time that it subjects the shareholders to increased risks by a sale of control. The importance of arriving at a "value" based on current market prices or a reasonable approximation thereof rests in the fact that accounting is being required because "control," rather than individual shares, was sold. An artificial process of valuation is therefore necessary to recreate a hypothetical sale of individual shares (subject to the possible exception mentioned in note 248 infra).


247. Compare the treatment of a similar problem in Sautter v. Fulmer, 258 N.Y. 107, 179 N.E. 310 (1932), and note 37 supra. Judge Swan stated in his dissenting opinion in the Perlman case: "The controlling block could not by any possibility be shorn of its appurtenant power to elect directors and through them to control distribution of the corporate product. It is this 'appurtenant power' which gives a controlling block its value as such block. What evidence could be adduced to show the value of the block 'if shorn' of such appurtenant power, I cannot conceive, for it cannot be shorn of it." 219 F.2d at 180. It may be suggested that evidence could be introduced to show the value of the shares considered as an aggregate of individual units rather than as a control block.

248. One possible exception to an accounting based on the total premium received for controlling shares over their value considered as individual units might be to
B. Actions by Individual Shareholders

1. Choice of Form of Suit

After controlling shares have been sold, remaining shareholders who wish to complain of the transaction face the necessity of choosing between a derivative suit asserting rights of the corporation and a personal suit on their own behalf. The necessity for making such a choice is not confined to control transactions. Since the theoretical differences between corporate rights and shareholder rights are not always simple to define, the choice of a remedy poses problems in a wide variety of situations giving rise to shareholder complaints. However, the choice creates special problems in the control sale cases.

Cases examined in Part One of this article involved complaints by former shareholders whose shares had been sold either directly to a third party or resold by a manager or controlling shareholder after purchase from the complaining shareholder. In such cases, although there were questions as to substantive liability, no suggestion was made that the one complaining should have brought an action asserting rights of the corporation or otherwise than on his own behalf. On the other hand, the bulk of the litigation involving sales of control in which such selling shareholders were not complaining has been instituted formally on behalf of the corporation or has involved the assertion of "corporate" causes of action. Direct, personal actions by remaining shareholders asserting rights growing out of sales of control have been attempted infrequently and have not been successful when tried. In one case, in which managers were alleged to have frustrated shareholders' acceptance of a third party's offer for all the shares, relief would probably not have been granted even if a corporate cause of action had been asserted, because of the court's reliance on the "no fiduciary duty" doctrine. In another case the court plainly denied permit the seller of control to have a credit, nominal at best, attributable to the fact that the buyer saved time and expense by being able to purchase a block of shares in one transaction instead of through numerous negotiations.


250. Mairs v. Madden, 307 Mass. 378, 30 N.E.2d 242 (1940). Compare Benson v. Braun, 286 App. Div. 1098, 145 N.Y.S.2d 711 (2d Dep't 1955), in which the court stated that it was upholding a complaint alleging a combined personal and derivative suit for accounting for profits from a control sale "... even if only one of the causes of action is sufficient." Ibid.
relief because the shareholder had failed to prosecute his action in
derivative form on behalf of the corporation.251

Whether a shareholder shall proceed individually or derivatively
does not depend upon whether or not he has been injured. A misap-
propriation or diversion of physical assets identifiable as “corporate”
property injures the individual shareholder by reducing the value of
his shares; nevertheless a derivative action has been required for the
redress of such an injury.252 Although the decision that a shareholder
should proceed by one form of suit rather than another is customarily
couched in terms of “personal cause of action” or “corporate cause of
action,” the selection of the appropriate remedy, and the supervision
of that selection by the courts, is basically one of administration. Fund-
damentally the question is: how may shareholder complaints best be
worked out?

Although numerous detailed questions arise in the solution of
that problem,253 a major administrative problem is the form of the
relief to be granted. If a remaining shareholder successfully prosecutes
an action in which he has complained of a sale of control and has ob-
tained recognition of his claim that the controlling shareholder should
account for a premium received on the sale, to whom should the pay-
ment of that premium be made? Although not exhaustive of the pos-
sible forms of relief, two may be suggested: payment of the entire
premium into the corporation’s treasury, or payment to the complaining
shareholder or shareholders of a proportionate share of the entire
premium. The choice between those two possibilities poses two com-
peting considerations:

have the right to sue the wrongdoer directly in a case involving sale of control.
Heineman v. Marshall, 117 Mo. App. 546, 92 S.W. 1131 (1905). Relief was denied
to a creditor alleging a sale of stock in fraud of creditors in Donaldson v. Andresen,
300 Pa. 312, 150 Atl. 616 (1930).

See Annot., 167 A.L.R. 279 (1947) for a comparison of cases illustrative of this
general approach to shareholder complaints and cases in which direct action has
been permitted on a showing of some special injury to individual shareholders.

253. Questions relevant to the administration of relief to complaining share-
holders are: (1) How far should the shareholder proceed within the internal cor-
porate organization in his search for relief? (2) Is the shareholder’s complaint
peculiar to himself, shared by some but not by all of the shareholders or shared in
common by all shareholders? (3) Do creditors have any interest in the matter of
which the shareholder complains? (4) Should the complaining shareholder be com-
penated by the corporation for his counsel fees and other expenses? (5) Do court
rules or statutes imposing restrictions (by way of requiring security for costs or
ownership of shares at the time of the wrong) properly apply to the particular type
of shareholder complaint being prosecuted? (6) Should any restrictions on the
capacity or ability to bring suit be imposed on shareholders, whatever the nature
of the complaint? (7) Who should have control over the prosecution of a shareholder
suit, over its discontinuance or settlement and over the execution of a judgment?
(1) Requiring a seller of control to account for personal gain is not primarily compensatory in purpose; its function is largely prophylactic. It is more desirable to prevent an unfair sale of control from being made than to force the remaining shareholders into litigation after the event. The virtue of requiring the defendant to disgorge his entire gain is that it increases the effectiveness of the prophylaxis; to require him to disgorge less than that amount is less beneficial. To direct the defendant to pay only a pro rata portion directly to remaining shareholders would mean that a seller of control would be most tempted to override the interests of minority shareholders in those cases where the minority is smallest and least able to protect itself by any form of combined action, since the extent of his liability in such cases might be minimal as compared to that part of his gain which he would be permitted to retain. Therefore, to obtain the maximum protection for minority shareholders, the defendant should be required to give up his entire premium.

(2) The conclusion that payment of the entire premium by the seller of control would increase his sense of responsibility raises another problem. It is doubtful that a court would order the payment of the entire premium directly to remaining shareholders. Even in those cases in which selling shareholders have sought redress by personal action, the courts have not awarded to them the entire premium received by the seller of control; selling shareholders have generally recovered only a proportionate share of that premium. The major alternative to ordering payment of the entire premium to the remaining shareholders is to direct it to be paid to the corporation. However, in such a case, the purchaser of control (who now owns shares in the corporation), or his transferee, would benefit. In effect he would recover a part of the price he had paid for his shares. This fact has troubled several courts which have considered whether a seller of control should be liable to the corporation. Their concern has been so great that it may have influenced their decision not to require any accounting. In the words of one court, such a result would be "unjust and inequitable." Other courts have solved this difficulty by requiring an accounting directly to the remaining shareholders on a proportionate basis, even though the suit was technically derivative.

254. See pp. 738, 747 and 755 supra.
256. See Keely v. Black, supra note 255; see also note 139 supra.
257. Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955); Commonwealth Title Ins. & Trust Co. v. Seltzer, 227 Pa. 410, 76 Atl. 77 (1910). As to one possible explanation for the form of relief in the Seltzer case, see note 146 supra.
It must be admitted that awarding recovery to the corporation may benefit the buyer who has cooperated in the transfer of control. However, it clearly will remove the incentive from a seller of control. The prophylactic benefit gained by the threat of removal of that incentive does not appear to be outweighed by any possible increase in buyers' incentive to acquire control. The dilemma might be avoided by recognizing a remedy other than one directed toward a money judgment. Such a remedy would be an injunction. Injunctions against control sales have been denied heretofore in part on the ground that complaining shareholders have failed to show that loss will result from the transaction; at times the plaintiffs have been expressly remitted to their remedies, if any, available upon a showing of loss after the control sale has been accomplished. In the light of the more sophisticated view of corporate injury which appears to be developing in the Perlman case, re-examination of the older injunction cases would presumably be required. At least with respect to particular purchasers, such as those in the Perlman case, it can be shown with a fair degree of certainty that the purpose of the purchase is inconsistent with use of certain of the corporation's opportunities in the future; injury to the corporation, in that sense, is therefore practically inevitable. Injunction might not be granted, however, if there is not a practical certainty but merely a risk that certain corporate opportunities will not be pursued by the purchasers. In such a case, a court could consistently deny injunctive relief and thereafter require accounting from the seller of control for taking personal profit in the face of that risk. A major objection to the remedy of injunction, from the standpoint of the corporation and remaining shareholders, is the fact that in many of the situations giving rise to complaint the control sale has been conducted in an atmosphere of secrecy. In such a case, injunction is not an available remedy, since the sale will have been accomplished before the complainants have become aware of that fact. Therefore despite

258. Compare Old Dominion Copper Mining & Smelting Co. v. Bigelow, 188 Mass. 315, 74 N.E. 653 (1905) (action by corporation for recovery of promoters' profits). "A corporation is not precluded from recovering for a fraud on it (the corporation) because the party committing the fraud is a stockholder." Id. at 327, 74 N.E. at 658.


260. In a case involving the dissolution of a corporation by its controlling shareholder for the latter's benefit, the court demonstrated a similar hesitancy to deny injunctive relief and a willingness to grant monetary relief after the event. Lebold v. Inland S.S. Co., 82 F.2d 351 (7th Cir. 1936) (injunction denied), 125 F.2d 369 (7th Cir. 1941) (liability for damages established), 136 F.2d 876 (7th Cir. 1943) (measure of damages).
the fact that the suggested dilemma may be avoided by resort to injunction, that remedy should not be exclusive of an accounting for gain.

If it be determined that a money judgment is an appropriate form of relief and that corporate policy would best be served by requiring payment of the entire premium to the corporation, in the present framework of the corporate institution, the derivative suit is the appropriate remedy. Although, as noted, some courts have felt free to mold relief in sale of control cases in such a way as to grant only a proportionate recovery even in a derivative suit, it is not probable that a shareholder's suit technically on his own behalf would be productive of a corporate recovery of the type described.

The conclusion that a derivative suit is the appropriate remedy implies that consequences other than the form of relief will flow from such a choice. The selection of the derivative suit from the present rigid dichotomy between derivative and personal suits almost automatically and uncritically settles other questions, such as the right of the plaintiff to the payment of counsel fees and the applicability of restrictions on the bringing of the suit. A reappraisal of the structure of shareholders' remedies might well dictate that some of those consequences should not flow from any kind of shareholder suit, whether personal or derivative, or whether to compel accounting for sales of control or for other wrongs. Such a reappraisal might indicate that the congeries of consequences which normally flow from choice of a particular type of suit are not unitary, but severable, and that the incidence of each consequence ought to be determined on its merits with relationship to the particular wrong complained of rather than automatically by the designation of the suit as derivative or personal. Until such reappraisal causes substantial changes in the structure of share-

261. The courts have not been in agreement with respect to the propriety of awarding relief in derivative suits directly to complaining shareholders. STEVENS, CORPORATIONS 794-97 (2d ed. 1949). Compare Keenan v. Eshleman, 23 Del. Ch. 234, 2 A.2d 904 (Sup. Ct. 1938), with Brown v. DeYoung, 167 Ill. 549, 47 N.E. 863 (1897); see also May v. Midwest Refining Co., 121 F.2d 431 (1st Cir. 1941); Harris v. Pearsall, 116 Misc. 366, 190 N.Y. Supp. 61 (Sup. Ct. 1921). Although the interests of creditors in the restoration of property appropriated by tortfeasors might dictate a corporate recovery, the fact that the corporation has reached such a point in the dissolution process as to make the interests of creditors irrelevant has led some courts to award relief directly to complaining shareholders. Sale v. Ambler, 335 Pa. 165, 6 A.2d 519 (1939); Bailey v. Jacobs, 325 Pa. 187, 189 Atl. 320 (1937).


holder remedies, those courts which deny the right of an individual remaining shareholder to prosecute a suit purely on his own behalf appear to be taking a correct approach.

Some difficulty may be anticipated on the theoretical level. Whether it is possible for a remaining shareholder, complaining of a sale of control, to state a "corporate cause of action" raises a question. The shareholder who sues both for damages caused by looting and for the seller's gain has no doubt stated such a cause of action. The action for damages is corporate largely because the replacement of identifiable physical assets benefits the whole body of those interested in that corporate property; creditors have a particular interest in such a corporate recovery. Although creditors do not have a similar interest in the recovery of gains from such a sale, the joinder of a corporate claim for gains in the same suit does not seem to be inappropriate. Where no looting losses are sought to be reclaimed, a suit for the control seller's gains may be cast in the form of a corporate suit when the theoretical basis for suit is the sale of a "corporate power." Only if the shareholder is complaining that he has been deprived of an opportunity to sell his shares (as in hypothetical Case F) may a shareholder's claim plausibly be considered exclusively personal and not corporate. Even in such a case, the prophylactic, rather than compensatory, nature of the relief and the consequent benefit to the whole body of shareholders in the increase of managerial and controlling shareholder responsibility may sufficiently support a theory of a corporate cause of action.

2. Integration of Remedies With Those of Selling Shareholders

The suggestion that a proportionate recovery by individual remaining shareholders does not adequately serve preventive purposes may create a problem in the integration of remedies. Part One of this article dealt with the rights of the selling shareholder, i.e., one whose shares formed a part of the controlling shares taken by a buyer, without his knowledge that a sale of control was being effected or that he was being deprived of an opportunity to participate in the profit from such a sale. It was observed there that the selling shareholder may have a remedy against the person who appropriates profit attributable to a sale of control. The remedy, when recognized by the courts, has almost uniformly consisted of the selling shareholder's recovery of a proportionate part of the differential between the amount per share received by the complainant for his shares and the amount per share received by the manager or controlling shareholder profiting from the
The effect of this remedy is to permit the defendant to retain a part of the premium which a buyer was willing to pay for a sale of control, so long as the defendant's own shares formed a part of the block sold. On the other hand, if the manager or controlling shareholder has sold controlling shares which he owns, at a premium over their value considered as individual shares, the proposed prophylactic recovery by the corporation in a derivative suit brought at the instigation of remaining shareholders would compel the defendant to disgorge all of the premium.

The administration of those two remedies would create problems in a case in which a control block consisting of less than all of the corporation's outstanding shares are sold to a buyer of control and some of the shares making up that control block have been furnished by selling shareholders who thereby acquire personal rights of redress. In such a case, not only selling shareholders but also remaining shareholders may have rights against the one who has profited from the sale of control. The problem may be examined in the light of the following assumed state of facts.

**Case H. Control Block Includes Shares Purchased from Selling Shareholders.** Corporation C has 100 common shares outstanding. D, the president and a director, owns 30 shares. L, M and N (selling shareholders) own an aggregate of 30 shares. X, Y and Z (remaining shareholders) own an aggregate of 40 shares. The market price of individual shares is $100 per share and remains constantly at that figure throughout all relevant times. D purchases the 30 shares owned by L, M and N and pays them $100 per share. D then sells 60 shares to Buyer at $150, thereby receiving a premium of $3,000 over the market price of the 60 shares sold. If it be assumed that all other circumstances of the sale are sufficient to create causes of action in favor of the selling shareholders (L, M and N) as well as Corporation C, the selling shareholders' right to recover $1,500 (that portion of the premium allocable to their shares) apparently overlaps the right which it has been proposed that Corporation C should have to recover the entire premium of $3,000. The seller of control under such circumstances therefore runs the risk of being subjected to what may be referred to as a "multiple liability."

---

265. See pp. 738, 747 and 755 *supra*.  
266. See note 14 *supra*.  
267. The "overlap" would be less apparent if D had purchased the shares of L, M and N at some price above or below the $100 figure hypothesized as the market price. The integration of remedies discussed in the text would become more complex in that case as well as in a case in which the market price fluctuated between the
The inadequate theoretical development by the courts of the substantive liability of those who profit from a sale of control makes it difficult to determine whether, if $D$ were required to pay $\$4,500$, he would be paying more than once for the same wrong or would simply be paying heavily for having committed two distinct wrongs. One argument for the proposition that the control seller has committed only one wrong might be that he has sold controlling shares without inviting participation in his profit by all interested parties (i.e., selling shareholders and remaining shareholders) and that recovery of all of that profit, whether by selling shareholders, the corporation or remaining shareholders, would satisfy all liability arising from the sale. However, the courts have considered that the rights of selling shareholders and those of other parties in the corporate institution are more distinct than such an argument assumes. Some courts have viewed the rights of selling shareholders as grounded in "fraud" and their recovery as an award of damages; others have viewed their rights as grounded in a breach of duty which gives rise to a prophylactic recovery of profits. It was suggested in the discussion of the rights of selling shareholders that they may in fact be injured by a sale of control under certain circumstances. A proportionate part of the premium received on a sale of control may serve as a rough measure of that injury. Selection of that particular measure is indicative of the fact that prophylaxis plays a significant role in the selling shareholders' cause of action, but it does not exclude compensation as an important basis for the selling shareholders' recovery. The corporate cause of action is less compensatory in purpose. Unlike selling shareholders, the remaining shareholders will continue to be shareholders and through subsequent sales may be able to recoup losses which have flowed from having been deprived of opportunities to merge, sell assets or sell shares. Therefore the corporate recovery is mainly prophylactic. It is more clearly

time of $D$'s purchase from $L$, $M$ and $N$ and his sale of their shares and his own shares to Buyer. In such circumstances, the "premium" for which the selling shareholders have a proportionate claim might be a figure different from the "premium" for which $D$ may be held liable to the corporation. The basic problem of multiple liability discussed in the text would remain the same, however. (In the discussion of Case H in the text, it is hypothesized that the market price mentioned can reasonably be found by the court to represent the fair value of shares considered as individual units.)

268. A similar problem arises under § 10(b) (and rule X-10B-5) and § 16(b) of the Exchange Act. See Loss, SECURITIES REGULATION 844 (1951). One can agree with Loss' analysis of the independence of the liabilities created by those two sections without being required to hold that the extent of recovery in a corporate suit for profits on a sale of control must be considered independently of the extent of the recovery by selling shareholders; the language and purposes of the Exchange Act sections raise considerations different from those which face a common-law court.

269. See Part One supra for an analysis of the variety of theoretical bases for selling shareholders' suits.
so when the theory of recovery is the sale of a "corporate power" or "opportunity" and would be most clearly so if the courts were to adopt the broad policy that no seller of controlling shares may benefit from a gamble that the corporation will continue to operate profitably.

The conclusion that the selling shareholders' recovery is basically compensatory leads to the suggestion that no attempt should be made to integrate the selling shareholders' and the corporation's remedies in any way which would preclude recovery by the former. Although the chronology of suits may result in the recovery of judgment first by the selling shareholders and later by the corporation, the chronology may have a reverse result. If the selling shareholders recover their proportion of the defendant's premium, a subsequent recovery by the corporation of the entire premium would not appear to be required by the prophylactic purposes sought to be served by a corporate recovery. The goal should be only that the defendant disgorge his profits; allowing the defendant a credit for the amount he has paid to selling shareholders would be consonant with that goal. The allowance of such a credit should be well policed, however. Conceivably, the defendant might have cooperated with the selling shareholders in a sale of control, using the device of a selling shareholders' suit to share at least some part of his profit with them. More probable than such a conclusive suit would be a sham private restitution or settlement without trial. Payments by the defendant to selling shareholders should be subjected to close scrutiny before the court allows the defendant a credit on the basis of his argument that his clear profit from the sale has been decreased.

If the corporation sues first, allowance of a credit merely for potential liability to selling shareholders would not be consonant with the purpose of requiring the defendant to disgorge his profits. However, a court may be concerned at this point with the possibility of multiple recovery. It may be aware of the fact that the compensatory character of the selling shareholders' claims demand recognition even if the claims are asserted after the corporation has had full recovery.

270. It may be argued that permitting a direct recovery by selling shareholders for their part of the premium and corporate recovery of the remainder of the premium will give selling shareholders a larger share than remaining shareholders will receive (since the latter must share with the buyer of control the amount recovered by the corporation). Equivalence between the selling shareholders' recovery and that of the remaining shareholders could be accomplished only by awarding to each of them a share in the control seller's premium measured by the ratio between their shares and the total outstanding shares. However, this would permit the control seller to retain a portion of his premium and would gain equivalence at a sacrifice in prophylaxis. Although the remedy suggested in the text gives a greater proportionate recovery to selling shareholders, it appears to be justified on the ground that they have suffered an irrevocable loss; they have sold their shares, remaining shareholders have not.
Such concern should not cause confusion between the corporation's substantive right and the problem of damages. The corporation should not be denied recovery of the full premium unless the defendant establishes more than merely potential liability to selling shareholders. As mentioned above, the defendant may be able to establish that a proper private settlement has taken place. If suits by the selling shareholders and the corporation are proceeding simultaneously, a stay in the corporate suit would give time for determination of the amount for which the defendant will be held liable to selling shareholders. If selling shareholders have not brought suit and the defendant is unwilling to make any payment to them without judicial determination of his liability, then, aside from exploring the possibilities of interpleader under the modern statutes and rules which have removed many of the traditional restrictions on the use of that procedure, he may find that at least some risk of multiple damages is part of the price he must pay for so manipulating a transaction in corporate control as to injure so many interests in the enterprise.


272. Defendant would find his use of interpleader blocked by traditional requirements. Inter alia, there must be privity between the claimants, the defendant must not have incurred independent liability to either claimant, the defendant must have or claim no interest in the subject matter, and the same debt or duty must be claimed by all claimants. 4 Pomeroy, EQUITY JURISPRUDENCE § 1322 (5th ed. 1941); Chafee, Modernizing Interpleader, 30 YALE L.J. 814, 822 (1921). However, traditional restrictions have been relaxed by the federal interpleader statute, 62 STAT. 931 (1948), 28 U.S.C. § 1335 (1952), and by some state procedures, e.g., PA. R. Civ. P. 2301-25. Under PA. R. Civ. P. 2306, the defendant may still encounter difficulty, since the court is given discretion to deny a petition for interpleader if the defendant "... has admitted the claim of, or subjected himself to independent liability to, the plaintiff or any claimant, with knowledge that an inconsistent claim would be later asserted against him by any known or unknown person." If the manager or controlling shareholder incurs liability to the corporation in a control sale, he may be said to have done so with knowledge that selling shareholders from whom he purchased shares may subsequently assert a claim against him.

273. In the examination of the rights of selling shareholders, it was stated that Case D poses problems substantially different from those suggested by Cases A, B and C. Discussion of Case D under state law (see p. 755 supra) and under section 10(b) of the Exchange Act (see p. 773 supra) was deferred until the total problem of the liability of the manager and controlling shareholder had been examined and the policies behind recovering profits from a control sale fully explored. As noted in the previous discussion of Case D, Buyer has purchased D's shares at a premium and also has purchased other outstanding shares at a lower price without D's assistance or knowledge. In such a case, it is difficult to support a claim under either state law or the Exchange Act that D has deprived other shareholders of any opportunity which Buyer had originally proposed to make available to them. Of course, a rule requiring D to share his gains with other shareholders should be applied only if it is thought desirable to compel particular action by D. If D's shares are not purchased by Buyer until after Buyer has purchased other shares, it is too late for D to protect other shareholders. If other shares are not purchased until after the control sale, then other remedies are available. As suggested in the text, the practical effect of the Perlman case may be to require D to bargain for an even-handed offer to all other shareholders or to refuse to sell his shares at a
IV. Actions Under the Federal Securities Statutes by or on Behalf of the Corporation or Remaining Shareholders

The federal securities statutes do not provide the corporation with a cause of action with respect to a control sale as such. As noted previously, section 16(b) has a limited impact on those cases in which corporate insiders purchase shares for resale. It does not reach those cases, such as Cases E, F and G, in which the insider has not supplemented his own shares by making purchases from other shareholders.

It is subject to question whether section 10(b) and rule X-10B-5 furnish relief to a corporation asserting that it or its remaining shareholders have been adversely affected by sales of control such as those which took place in the looting cases or in Cases E, F and G. The fact that no civil cause of action is given by the terms of the rule to the corporation or to shareholders suing on its behalf should not alone serve as a barrier to judicial recognition of the corporation's claim. The consistent ruling that a civil remedy is available to an aggrieved selling shareholder in the event of violation of the rule is persuasive that a civil remedy may be similarly available to the corporation, but only if a transaction involving a sale of control falls within the activities proscribed by the section and rule as a substantive matter.

Words such as "public interest" and "protection of investors" in the section, "any person" in subsection (c) of the rule, and the rule's broad definition of "manipulative or deceptive device or contrivance" are literally capable of comprehending those sales of control which result in looting losses to the corporation as well as those in which the interests of remaining shareholders are ignored for the private benefit of the sellers of control, although the extent to which that language permits the courts to proceed beyond common-law doctrines with re-

---

274. See text at pp. 759-62 supra.
275. See cases cited in note 94 supra.
spect to the duties of managers and controlling shareholders is subject
to some speculation.\textsuperscript{276}

The primary difficulty in determining whether such cases fall
substantively within the section and rule arises from the necessity of
interpreting the words “in connection with” the purchase or sale of
any security. That language is found in both the section and the rule.
The question is presented whether those words limit the operation of
the section and rule to those “devices and contrivances” (as defined in
the rule) which operate upon purchasers or sellers of securities, or
whether the section and rule proscribe practices which are injurious
to other persons, not purchasers or sellers, so long as a purchase or sale
of a security is one of the steps in the effectuation of those practices.

In \textit{Birnbaum v. Newport Steel Corp.},\textsuperscript{277} the only case in which a
court has written an opinion on this matter, it was stated that “. . .
Rule X-10B-5 extended protection only to the defrauded purchaser
or seller.” In that case, shareholders of Newport Steel Corporation
brought a combined personal and derivative suit alleging that section
10(b) and rule X-10B-5 had been violated in connection with Feld-
mann’s sale of Newport’s control.\textsuperscript{278} The complaint emphasized mis-
representations and nondisclosures in Feldmann’s reporting on the
rejection of a proposed profitable merger of Newport and another steel
company and in the reporting, by the new president of Newport, on the
sale of Feldmann’s shares. The district court dismissed the complaint
for failure to state a cause of action\textsuperscript{279} and the dismissal was affirmed
by the Court of Appeals for the Second Circuit. The court looked to
the SEC’s apparent purpose in promulgating rule X-10B-5 to deter-

\textsuperscript{276} McManus v. Jessup & Moore Paper Co., Civil No. 8015, E.D. Pa., July 30,
1948, in which the court denied motions to dismiss the complaint, without opinion, is
significant not only because it involved a suit by non-sellers, but also because of the
substantive cause of action alleged under rule X-10B-5. In a mixed personal and
derivative suit, plaintiff minority shareholders alleged that three officers and directors,
owners of over four-fifths of the voting shares of a paper company, sold their shares
and control of the company to a newspaper corporation at $60 a share at a time
when the paper company’s shares were selling on the over-the-counter market at
$6 to $8 a share. Plaintiffs alleged that the paper company had a large surplus at
the time of the sale and that the buyers intended to use a part of this surplus to
convert its operations to the manufacture of newsprint, changing the company’s
course of business and operating policies to its detriment and for the buyer’s benefit.
\textit{Inter alia}, plaintiffs alleged that the sellers of control had breached fiduciary obliga-
tions by making such a sale to outsiders under the above circumstances, by depriving
minority shareholders of opportunities to participate in disposition of the assets and
in the sale of shares above the market price and by failing to make full disclosures
of all material facts. The buyer, included as a defendant, was alleged to have
conspired with the control sellers in violating rule X-10B-5.

\textsuperscript{277} 193 F.2d 461 (2d Cir. 1952), 100 U. Pa. L. Rev. 1251.

\textsuperscript{278} The Perlman case, discussed at pp. 809-17 \textit{supra}, and the Birnbaum case
arose out of the same transaction. Jurisdiction in the Perlman case was based on
diversity of citizenship.

mine the meaning and scope of its "loosely drawn" language. The SEC's purpose was found to be the creation of prohibitions against fraud by purchasers comparable to those already contained in the Securities Act with respect to fraud by sellers, and the court went no further than it considered necessary to carry out that purpose.

There is no affirmative evidence to indicate that a result contrary to that reached in the Birnbaum case was clearly compelled. It has been reported that the Commission has not taken a position which would shed light on the question. Nevertheless, even in the absence of a clear cut statement by the Commission or of a rule deliberately drawn to cover the precise situation posed in the Birnbaum case, there are grounds for suggesting that relief could reasonably have been granted, and that the court may have been unduly concerned with the implications of granting that relief. In the first place, as recognized by the court, the rule is literally broad enough to encompass the factual situation before it. Indeed, one district court had previously denied motions to dismiss a complaint alleging violations of rule X-10B-5 in connection with a sale of control under circumstances similar to those in the Birnbaum case.

In the second place, there is evidence that the Commission's desire to prohibit frauds by purchasers may have served only as the occasion for its use of a rule making power, in a broad fashion, which it had not fully exercised up to that point. As noted, that purpose was found to be the prohibition of fraud by purchasers, a prohibition designed to fill a loophole in the securities statutes, section 17(a) being limited to

280. SEC Securities Exchange Act Release No. 3230, May 21, 1942, stated in introduction to the text of rule X-10B-5: "The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase."

Section 17(a) of the Securities Act, in language almost identical with that used by the Commission in rule X-10B-5, applied only to the offer or sale of securities. The "previously existing rules" referred to by the Commission were the rules relating to over-the-counter markets adopted pursuant to § 15(c) of the Exchange Act.

281. In S. Rep. No. 792, 73d Cong., 2d Sess. 18 (1934), the only reference to section 10(b) is as follows: "Subsection (b) authorizes the Commission by rules and regulations to prohibit or regulate the use of any other manipulative or deceptive practices which it finds detrimental to the interests of the investor." Sales of corporate control were not mentioned in the reports accompanying the Exchange Act. S. Rep. No. 792, supra; S. Rep. No. 1435, 73d Cong., 2d Sess. (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934).

282. "The Commission has taken no position on the question of the applicability of the rule where the person allegedly defrauded was neither a seller nor a buyer." Loss, Supplement to Securities Regulation 841 (1955).

283. McManus v. Jessup & Moore Paper Co., Civil No. 8015, E.D. Pa., July 30, 1948 (dismissed with prejudice upon stipulation). As stated in note 276 supra no opinion was filed in support of the court's denial of motions to dismiss.
fraud by sellers. But despite that stated purpose, the language of the rule covers frauds by "any person" (not merely by purchasers) "in connection with the purchase or sale of any security." Even in the Birnbaum case the court demonstrated its recognition of the rule's reach to frauds by sellers as well as by purchasers; the court cited its own prior opinion in which a fraud by sellers was held to fall within the rule.284 If the rule has a broader scope than may be attributed to it by reference to the Commission's stated purpose in its adoption, the question remains whether the court was obliged to draw the limit of its scope at the precise point chosen.

The court may have been motivated by a consideration not wholly relevant to the specific situation before it. The only issue presented was whether section 10(b) and rule X-10B-5, in combination, afforded grounds for corporate and shareholder objection to activities in connection with a sale of control. After disposing of rule X-10B-5 because of the purpose of its adoption, the court observed that section 10(b) was not directed toward "fraudulent mismanagement of corporate affairs."285 The plaintiffs' allegation that "fiduciary obligations" had been violated by the defendants may have drawn the court into overestimating the consequences of granting relief in the case before it. It may be true, as a general proposition, that section 10(b) is not broadly oriented toward problems of "fraudulent mismanagement." Concededly, a court should hesitate to impute to Congress the intention to draw into the federal courts innumerable facets of the internal management of corporations for attack by shareholders purely on the basis of the rule making power in section 10(b). If such an intention were to be imputed to Congress, it might thus be possible to engraft a completely new body of federal "common law" of corporations on the slim structure of section 10(b), permitting examination of such matters as dividend policy and business practice. The creation of such a body of law could conceivably be justified on the ground that "fraudulent mismanagement" always constitutes a practice "in connection with" the purchase or sale of a security because it necessarily affects the rights of someone who purchased some of the corporation's shares at some time in the past. A reading of section 10(b) which would permit that examination of corporate affairs could be made only if the phrase "in connection with" the purchase or sale of a security were to be given only minor substantive significance. Thus the phrase

284. Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951). There are doubts whether the protection afforded by the rule is comparable to that available to sellers. See Loss, SECURITIES REGULATION 1054-65 (1951).
would operate as a type of jurisdictional ground, much as the language of the section and rule referring to the "means or instrumentalities of interstate commerce or of the mails" now operates.\footnote{286}

It was not necessary to read section 10(b) so broadly to decide the \textit{Birnbaum} case favorably to the plaintiffs. On the facts, the question raised was whether the grant of rule making power in a statutory section, itself "loosely drawn," fairly gives rise to an inference that Congress gave flexibility to the Commission to identify and proscribe practices detrimental to investors and necessarily involving the purchase and sale of securities, even though such practices were not prevalent at the time the statute was passed. Corporate managers who find more traditional share trading devices closed to them by specific provisions of the statutes, such as section 16(b) of the Exchange Act, may seek new methods of using the avenue of share trading to gain advantages to the detriment of investors. Section 10(b), more broadly interpreted than it was by the court in the \textit{Birnbaum} case, would give the Commission flexibility to meet new situations as they arise. Under circumstances discussed previously in this article, a sale of control may be injurious to investors and their collective representative, the corporation. In a sense, such a sale may be said to be corporate mismanagement. But at the heart of the transaction is an abuse of the securities trading process; the terms of section 10(b) direct the Commission toward proscribing such abuses.

It must be admitted that there is room for debate even over the extent to which section 10(b) gives the SEC supervisory power over the securities trading process as distinguished from fraudulent mismanagement of corporate affairs. However, the scope of the section with respect to such supervisory power was not squarely posed in the \textit{Birnbaum} case;\footnote{287} the reach of rule X-10B-5 was the more immediate issue. Concern that the rule might burgeon into an expanded common law of corporations may have influenced the court as fully as its analysis of the Commission's purpose in promulgating the rule. Judicial insistence that only those transactions should be considered to fall under the proscriptions of that rule in which a purchase or sale of securities plays the major role would alleviate much of the difficulty which may have been anticipated by the court.

\footnote{286. See text at p. 763 \textit{supra}.}

\footnote{287. That the court was focusing on §10(b) as a basis for examination of fraudulent mismanagement and breaches of "fiduciary duty" may be observed from its observation that Congress did not intend that §10(b) should be the vehicle for protecting shareholders against breaches of "fiduciary duty" by insiders, since Congress left no doubt as to its meaning when it did intend to grant such protection by enacting §16(b). 193 F.2d at 464.}
CONCLUSION

It is evident that the basic assumption that corporate managers shall not absolutely be foreclosed from owning and trading in shares of their corporations has not prevented examination of transactions which constitute trading in corporate control. That assumption has, however, delayed recognition of the fact that control trading is a peculiar problem in its own right and requires analysis as a unitary question.

Litigation involving control transfers has fallen into two major categories: (1) cases in which selling shareholders have shown that they have contributed shares forming a part of a controlling block but have been deprived of benefits attaching to a control sale; (2) cases in which remaining shareholders, the corporation or trustees in bankruptcy have objected to control sales because of discernible injury or loss of opportunities. In the first class of cases, the common law has proceeded in its usual fragmentary fashion to work out mechanisms by which protection can be afforded to the selling shareholder, although consistency of result and doctrine has not been marked. The variety of factual patterns through which managers and controlling shareholders have obtained personal benefit from sales of controlling shares to the exclusion of other selling shareholders has resulted in the application of a variety of doctrines ranging around indefinite concepts of fraud and deceit. Rarely have the courts articulately analyzed the basic question of corporate policy which the cases present: should managers or controlling shareholders be permitted to benefit from transfers of corporate control to the observable exclusion of shareholders whose shares have entered into the control block? In result, however, the courts are beginning to answer the question in favor of the whole body of shareholders.

The federal securities statutes have not been addressed to the specific problem of control transfers as they affect selling shareholders. Rule X-10B-5 has been designed to correct specific deficiencies in common-law doctrine in a more generalized area of problems. It has been applied from time to time in control sale cases, but not all of the transactions which have been considered at common law have come up for examination under the rule. On the whole it offers an opportunity for a wiser approach to the basic corporate problem than many of the common-law courts have demonstrated. Section 16(b) of the Exchange Act has afforded a prophylactic remedy in a limited number of cases but is not completely applicable to control sales because of its limitation to issuers with listed securities and because of its fail-
ure to reach cases in which selling shareholders have been induced to transfer shares directly to third parties.

In the second major class of cases, those not involving selling shareholders, the law has moved more slowly to impose sanctions on those who sell control. Where the sale has resulted in definite and discernible depletion of corporate properties, the likelihood that the transaction will result in the imposition of liability on the sellers of control is fairly great. In cases where the remaining members of the corporate institution are unable to point to specific depletion of assets, courts have been less willing to require any accounting from sellers of control. Some strides have been made in the direction of protecting remaining shareholders where specific profitable opportunities to sell their shares or the corporation’s assets have been diverted into a sale of control. At the frontier of the cases lies the problem of the owner of controlling shares who sells control at a premium under circumstances which do not entail diversion of such profitable transactions or which do not result in loss of specific corporate property. Thus far, the courts have been unwilling to require every seller of control to account for his profit; control as such has not yet attained the status of a “corporate asset.” There is observable a slight tendency toward a judicial willingness to break away from the concept of control as a “natural” incident of the ownership of large blocks of shares. The congeries of rights and powers which follow controlling shares are being segregated for separate examination. As the cases appear before the courts, and as more and more shareholders point out that specific intangible but describable incidents of controlling shares are improperly the subject of private bargaining, the courts will be faced with a choice. Shall they revert to confining accountability only to those cases where identifiable book assets have been lost as a result of the sale, or shall they move in the direction of a broad rule of accountability in all control sale cases? The latter alternative has merit.

The risk of losing the peculiar gains which flow from a control sale may discourage the purchase and resale of outstanding shares by a manager or controlling shareholder. Even though a selling shareholder may not benefit by a corporate recovery of the profit from the resale of his shares, the corporate remedy may tend to prevent the occasion for a shareholder’s complaint from arising. In addition the risks to remaining shareholders attendant upon basic changes in corporate policy are already substantial; there should not be added the risk that such changes will be made because a controlling shareholder is making a personal profit. It is true that in specific cases integration of the corporation into an enterprise owned by the purchasers of control may
result profitably to the corporation, even though such integration requires the abandonment of other potentially profitable opportunities. This possibility should not obscure the fact that the seller of control at a premium price is making a unilateral determination that his corporation should gamble on its future prosperity, without consulting other shareholders to determine whether they are willing to make that same gamble. The law normally places in the hands of the one who owns majority shares or can garner majority votes the power of making decisions with respect to the corporation's future. But the pragmatic necessity of conducting corporate affairs through rule by the majority does not justify exercise of majority power when the benefits of that exercise are all on one side and the risks are all on the other.

If it is objected that a rule requiring accounting for gain when only control is bargained for and sold will deprive the controlling shareholder of benefits normally his, it can be said that the conclusion assumes the answer to the question. That the economics of control sales has traditionally resulted in a private benefit accruing to holders of control does not prove that the result should be encouraged. A balance of the interests of all shareholders is involved; only when that balance has been established may it be stated what the controlling shareholder's property rights are and what they are not. It may be further objected that a requirement of accounting for premium prices received from a sale of control may serve to stagnate corporate ownership, that there are greater risks from restraining sales of controlling shares than from permitting new blood to enter the corporation by purchase of control. Insistence on an even-handed offer to all shareholders may block some control transfers; it will not block all of them. Further, it is still to be shown that there is inherent virtue in protecting a system whereby one block of shareholders largely unresponsive to their fellows is supplanted by another.288

288. Other methods of changing corporate control, bringing infusions of new blood, do not possess the inherent disadvantages of the block transfer of control described in this article. In striking contrast to such block transfers, accomplished with no publicity and no opportunity for shareholders to exercise informed choices, is the change or potential change in management which accompanies a proxy contest. In corporations under management or minority control, proxy solicitation by non-managers opens corporate affairs to public debate and creates opportunities for shareholders to choose between the present management and a proposed new one. The pressure of outside forces on the internal operations of the corporation may not result in the substitution of new managers; nevertheless that pressure may have the beneficial effect of increasing management concern for shareholder interests. However the fact that minority shareholders of a majority controlled corporation do not have the same residual voting powers as are held by shareholders of a management or minority controlled corporation should not dictate results different from those suggested in this article with respect to block transfers of majority control. The fact that the voting system cannot be used by such minority holders for their own protection does not require that other methods of protecting non-controlling minority interests should be ignored.
Regard for the interests of scattered and unorganized shareholders may lead corporate managers and controlling shareholders to refuse to sell controlling shares unless an even-handed offer is made by the prospective buyer to all shareholders. Many managers and controlling shareholders will adopt this practice without being goaded by the law. Experience has demonstrated, however, that the standards of business ethics alone do not carry all before them. It may eventually appear that fairness to non-controlling shareholders may dictate the adoption of legislation permitting sales of controlling shares at premium prices only upon provision being made for the purchase of non-controlling shares, in a manner now provided in the merger statutes. Until such time, the federal securities statutes may supply the framework for judicial appreciation of the fundamental corporate problem involved in control sales, although the limitations inherent in section 16(b) of the Exchange Act in its present form and the growing judicial gloss on rule X-10B-5 may interfere with their utility. The task of developing the law applicable to control sales may rest heavily on common-law courts. They have available to them at the present time all of the doctrines necessary for handling the control sale cases in a manner consistent with the protection of investor interests. The fragmentary fashion in which the diverse issues presented by control sales are presented to those courts should not obscure the necessity for working out a corporate policy which imposes responsibility where power resides.

In a minority or management-controlled corporation, there is always the possibility that an outsider will prepare for a proxy fight by garnering a core of shares from scattered minority holders in order to be able to appeal successfully for additional votes. The purchase of such a core of shares is almost a necessary incident of such a process of corporate change, and no criticism is intended of non-controlling shareholders who sell their shares to an outsider preparing for the proxy contest. Nor is any criticism directed toward non-controlling shareholders who respond to a prospective buyer's public call for tenders even though the buyer announces his intention to acquire a majority of shares; a shareholder selling under such circumstances shares with others an opportunity to decide whether to remain with the corporation under new management or to sell out.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INTRODUCTION</strong></td>
<td>725</td>
</tr>
<tr>
<td><strong>PART ONE. ACTIONS BY SELLING SHAREHOLDERS</strong></td>
<td>730</td>
</tr>
<tr>
<td>I. Actions Under State Law</td>
<td>730</td>
</tr>
<tr>
<td>A. Actions Against Managers or Controlling Shareholders Who Purchase for Resale or Advise Sale to Buyer of Control</td>
<td>730</td>
</tr>
<tr>
<td><em>Case A.</em> Selling Shareholders Do Not Know That Buyer Is Acquiring Control</td>
<td>730</td>
</tr>
<tr>
<td><em>Case B.</em> Selling Shareholders Do Not Know Price at Which Buyer Is Acquiring Control</td>
<td>731</td>
</tr>
<tr>
<td>1. Misrepresentation</td>
<td>733</td>
</tr>
<tr>
<td>2. Nondisclosure</td>
<td>740</td>
</tr>
<tr>
<td>B. Actions Against Managers or Controlling Shareholders Who Do Not Deal Directly With Selling Shareholders</td>
<td>750</td>
</tr>
<tr>
<td><em>Case C.</em> Buyer Initially Negotiates for Purchase of All of the Shares</td>
<td>750</td>
</tr>
<tr>
<td><em>Case D.</em> Buyer Negotiates for Purchase Only of the Controlling Shares</td>
<td>750</td>
</tr>
<tr>
<td>II. Actions Under the Federal Securities Statutes</td>
<td>758</td>
</tr>
<tr>
<td>A. Actions Against Managers or Controlling Shareholders Who Purchase for Resale or Advise Sale to Buyer of Control</td>
<td>764</td>
</tr>
<tr>
<td>1. Misrepresentation</td>
<td>764</td>
</tr>
<tr>
<td>2. Nondisclosure</td>
<td>769</td>
</tr>
<tr>
<td>B. Actions Against Managers or Controlling Shareholders Who Do Not Deal Directly With Selling Shareholders</td>
<td>773</td>
</tr>
</tbody>
</table>
# TABLE OF CONTENTS (Continued)

<table>
<thead>
<tr>
<th>PART TWO. ACTIONS BY COMPLAINANTS OTHER THAN SELLING SHAREHOLDERS</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>III. Actions Under State Law</td>
<td>775</td>
</tr>
<tr>
<td>A. Actions by or on Behalf of the Corporation</td>
<td>775</td>
</tr>
<tr>
<td>1. Against Controlling Shareholders When Sale Is Followed by Looting or Looting Is Anticipated</td>
<td>779</td>
</tr>
<tr>
<td>2. Against Controlling Shareholders When Sale Is Not Followed by Looting or Looting Is Not Anticipated</td>
<td>797</td>
</tr>
<tr>
<td>a. Liability Based on Diversion of Specific Opportunities</td>
<td>797</td>
</tr>
<tr>
<td>Case E. Offer of Merger or Purchase of Assets</td>
<td>797</td>
</tr>
<tr>
<td>Case F. Offer To Purchase All Outstanding Shares</td>
<td>797</td>
</tr>
<tr>
<td>Case G. Offer To Purchase a Controlling Block of Shares</td>
<td>797</td>
</tr>
<tr>
<td>b. The Development of New Bases of Liability</td>
<td>809</td>
</tr>
<tr>
<td>c. Measure of Liability</td>
<td>817</td>
</tr>
<tr>
<td>B. Actions by Individual Shareholders</td>
<td>821</td>
</tr>
<tr>
<td>1. Choice of Form of Suit</td>
<td>821</td>
</tr>
<tr>
<td>2. Integration of Remedies With Those of Selling Shareholders</td>
<td>826</td>
</tr>
<tr>
<td>Case H. Control Block Includes Shares Purchased From Selling Shareholders</td>
<td>827</td>
</tr>
</tbody>
</table>

| IV. Actions Under the Federal Securities Statutes by or on Behalf of the Corporation or Remaining Shareholders | 831 |
| CONCLUSION | 836 |