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The Investment Value of Control Stock

David Cowan Bayne, S.J.*

In early 1973 when Victor Rikling, longtime contrôleur of Mythical Rikling Sheet and Tube Corporation,¹ exacted a \$3.45 million "premium" over market from Norton Jarneen and ostensibly handed over control,² he enunciated the most fundamental questions in the complex field of corporate control. Was this truly a bonus that Jarneen paid to Rikling? Or merely Jarneen's investment evaluation of the control stock with Jarneen in control? Was Rikling simply saying that a control block has an intrinsic and legitimate value considerably greater than a similar block without control? Were both maintaining that they alone, irrespective of the public owners, could determine in a private sale the "considerably greater" value of that control block? The answers to these complex queries will form the last major segment in the philosophy of corporate control.³

MYTHICAL RIKLING

From inauspicious beginnings in 1928, Mythical Rikling had grown internally and through merger (Dependable Steel) and acquisitions (Blaine-Spahn Steel, Havensend Steel, Ark-Weld) to \$100-million annual sales in the early seventies.⁴ By its forty-fifth year, 1972, MRST offered a wide range of steel products from pig iron and basic open-hearth steel, hot- and cold-rolled sheets to high-carbon spring wire and welded-wire fabric to line pipe, oil-well casing and structural-steel tubing. With four producing mills and 18 sales offices Mythical Rikling⁵ had become by 1972 a relatively substantial regional producer ranking just outside *Fortune's* select 500 top industrials.⁶ The 3.9-million shares outstanding in the hands of some 11,000 shareholders classified

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1. This lengthy hypothetical has been concocted to remove any stigma from the individuals and corporations actually involved.

2. *The Wall Street Review*, Mar. 27, 1973, at 4, col. 1; Jan. 26, 1975, at 10, col. 1.

3. The germinal principles were first presented in Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963).

4. GOODY'S INDUSTRIAL MANUAL 563 (1973) [hereinafter cited as GOODY'S].

5. Mythical Rikling Sheet and Tube Corp. Annual Report 14 (1973).

6. Mythical Rikling was just inside *Fortune's* 500 in the late sixties but had dropped out by the early seventies.

MRST as definitely a widely held corporation.⁷ No single shareholder, with the exception of the Rikling interests, owned over 10 percent of the stock.⁸

But that fiscal year ending just before Rikling's departure in March 1973 had been a troubled one. Earnings before taxes showed a disturbing 32-percent drop from \$7.9 to \$5.3 million, registering the lowest per-share return in five years, \$0.93.⁹ The common stock was trading on the NYSE in the midteens, with a two-million-share turnover in the seven months ending March, 1973.¹⁰ The regular dividend of \$0.60—down from a dollar in 1965¹¹—provided a below-average return. The firm had "been the subject of takeover rumors for months. On Feb. 29 Alabama-Atlantic Corp., Portland, Me., producer of building materials and paper, called off merger talks with Mythical Rikling."¹² But the rumors persisted. A spring management shuffle saw the appointment of a new treasurer, the realignment of six vice presidents and the replacement—after 44 years with the company—of the president Val Florian with Edward A. Harper¹³ who came with the 1969 acquisition of Ark-Weld, Incorporated.¹⁴

This was the gloomy panorama that Victor Rikling could so clearly discern from his Tribune Tower aerie. And he equally clearly wanted out. With astonishing speed—as late as March 8, 1973, the Annual Report still carried Mr. Rikling's remark: "Currently we are exploring, with Alabama-Atlantic Corp., the benefits . . . if the two companies are merged"¹⁵—he got what

7. Goody's, *supra* note 4, at 5.

8. Mythical Rikling Sheet and Tube Corp. Proxy Statement, March 17, 1974; United States Securities and Exchange Commission, Official Summary of Security Transactions and Holdings, Vol. 38-39 (1972-77).

9. Mythical Rikling Sheet and Tube Corp. Annual Report 9 (1972) [hereinafter cited as Annual Report].

10. Goody's, *supra* note 4. The volume for these months was undoubtedly increased appreciably by the frequent rumors of mergers and takeovers. The following is a rough capitulation:

September 1972	384,700
October 1972	179,300
November 1972	117,900
December 1972	455,200
January 1973	388,600
February 1973	312,300
March 1973	293,100
	<hr/>
	2,131,100

11. Goody's, *supra* note 4.

12. *Supra* note 2.

13. Annual Report, *supra* note 9, at 6.

14. Goody's, *supra* note 4.

15. Annual Report, *supra* note 9, at 3. The date discrepancy with

he wanted. A short 26 days after the Alabama-Atlantic call-off came the startling announcement:

NEW YORK—European Import Companies, Inc. has purchased blocks of stock in Mythical Rikling Sheet and Tube Corp. and Bonus Pig Iron, Ltd. from Victor Rikling, the Chicago financier, and one of his associates for about \$19,040,000.

It marks a major withdrawal from the Midwest steel and iron ore industry of the 72-year-old Mr. Rikling, chairman of the Narragansett and Maine Lines. The other seller of the stocks was James R. Weakly, long associated with Mr. Rikling in widespread business ventures.

European Import paid them \$25 a share for 525,000 shares, or about 13% of the outstanding share of Mythical Rikling Sheet and Tube Corp., a steel producer.¹⁶

European Import Companies, Incorporated, Norton Jarneen contrôleur, is the parent of European Import Railroad, a major rail company until recently subsidized by the federal government.¹⁷ "European Import has acquired at least three other companies within the past year."¹⁸

Since Mythical Rikling shares had been struggling along for the month prior to the Rikling-Jarneen deal in a range from 16-3/4 to 20-1/8¹⁹ Jarneen paid \$4.875 to \$8.25 over market—a 24-

the Wall Street Review release is explained by advance preparation of the annual report for printing.

16. *Supra* note 1.

17. *Id.*

18. *Id.* Apparently control of Chicago-Slopes Iron Co. was also acquired through the control of Mythical Rikling.

19. The following conspectus tells a story in itself. The dates are for trading, not reporting, and run Monday through Friday.

Date	Volume	Closing
February 26, 1973	4700	20 3/4
February 27, 1973	4000	20 3/4
February 28, 1973	8000	20 5/8
February 29, 1973	6500	20 1/8

("On Feb. 29 Alabama-Atlantic Corp. . . . called off merger talks. The Wall Street Review, Mar. 27, 1973, at 4, col. 1.)

March 1, 1973	26600	18 1/8
March 4, 1973	17700	17 1/4
March 5, 1973	8900	16 3/4
March 6, 1973	16700	18 3/4
March 7, 1973	5300	18 7/8
March 8, 1973	5900	18 1/8
March 11, 1973	7600	18 1/2
March 12, 1973	18200	19 3/8
March 13, 1973	22900	20 1/8
March 14, 1973	15600	19 3/4
March 15, 1973	9800	19 1/4
March 18, 1973	6400	19 1/2
March 19, 1973	8300	18 7/8
March 20, 1973	3100	19 3/8
March 21, 1973	17400	19 3/4
March 22, 1973	9300	19 7/8

to 49-percent markup—for a total premium ranging from \$2.6 to \$4.3 million,²⁰ averaging out at \$3.45 million. The spread for calendar 1972 was 22-1/8 to 11-1/4.²¹ For 1971 20 to 11-1/4.²² The 1972 earnings figure would have netted Mr. Jarneen a 3.7-percent return on his investment.

The immediate upshot was predictable: "Norton Jarneen, president of European Import, and [his brother-in-law] Egbert E. Setting, Jr., vice president of European Import, replace Mr. Rikling and Mr. Weakly as directors. . . ."²³ This left the seven-man board with two remaining Rikling nominees, Louis L. King, an attorney and "Vice President—Assistant to President" of the company, and Young D. Speydl, an outside director, in addition to Mr. Harper, Mr. Florian and Curt A. Yocum, "Vice President—Finance."²⁴

The plan took another step forward at the 1974 annual meeting: A third Jarneen man, Robert H. Holman, Chairman of Jarneen-dominated Circulator Corporation, replaced Curt Yocum. James E. Hullen, Jr. from the Harper-Ark-Weld days succeeded Val Florian who did not stand for reelection.²⁵

But Hullen's days were numbered. He did not fit into the final scheme of things, which jelled in early 1975 with the addition of the fourth Jarneen director on the seven-man board. With Hullen's demise came a presage of Mr. Harper's future and further bleak news of MRST profits and dividends:

YOUNGSTOWN—Ailing Mythical Rikling Sheet and Tube Corp. elected Lewis L. Singer, former chairman, president and chief executive officer of Regional Materials Services Ltd. [a

March 25, 1973	20600	20 1/2
March 26, 1973	73200	20 3/4
("European Import Purchases Stock From Victor Rikling." The Wall Street Review, Mar. 27, 1973, at 4, col. 1.)		
March 27, 1973	18400	20 1/4
March 28, 1973	7900	19 1/2
March 29, 1973	5600	19 1/2

20. The premium figure of \$3.45 million is arbitrary. Later analysis will establish guidelines for the determination of the correct amount of such a premium. This \$3.45 million, moreover, does not include a second premium paid by Jarneen to Val Florian, the former MRST president, for his 197,465 shares. The Wall Street Review, Feb. 13, 1974, at 20, col. 3. Nor is any possible premium paid for Bonus Pig Iron, Ltd. under discussion.

21. Goody's, *supra* note 4.

22. *Id.*

23. The Wall Street Review, *supra* note 2.

24. Annual Report, *supra* note 9, at 2.

25. Proxy Statement, *supra* note 8.

Jarneen company], to the new position of chairman of the executive committee. He was also named a director.

Mr. Singer will replace on the board James E. Hullen, Jr. who will remain vice president of Mythical Rikling. Mr. Hullen may possibly rejoin an expanded board in April.

Edward A. Harper remains president and chief executive officer of the steel company.

Mythical Rikling's earnings plunged 88.4% to \$405,000, or 10 cents a share, in the first nine months of 1974 from \$3.5 million, or 88 cents a share, a year earlier. Sales fell 10.7% to \$83.8 million from \$93.9 million. The company also omitted its third quarter dividend after paying 15 cents quarterly since 1967.²⁶

Short days later the *Review* gave the final fillip—the 1974 results:

YOUNGSTOWN—Mythical Rikling Sheet and Tube Corp. reported a \$176,000 loss in the fourth quarter . . . worse than a \$131,000 loss in the like 1973 period, . . .

Earnings for the year dropped sharply to \$229,000, or six cents a share, from \$3.4 million, or 85 cents a share in 1968. . . .

Edward A. Harper, president, said the year's profit decrease "was the result of unsatisfactory operations at the Havensend (Ohio) plant, including two major equipment failures and a fire. . . ."²⁷

Thus did the 1973 transfer of control of Mythical Rikling see its implementation in measured steps over a two-year period.

THE ISSUE DRAWN

Victor Rikling's questions have been vexing courts and commentators ever since the turn of the century. Two opposing schools—so antipolar in their convictions as to excite wonder at the gulf between them—have steadfastly confronted each other throughout the entire period. Certainly no acceptable resolution of the conflict has been found down to the present.

At one far pole stands the Court of Appeals of New York. In the 1899 case, the famous *McClure v. Law*,²⁸ the court posed the problem: "The question is therefore presented whether the defendant is bound to account for the money received from Levy for the transfer to him and his associates of the management and control of the Life Union, together with its property and effects."²⁹ In answering its own question the New York court had resort to *Perry on Trusts*—and thus added its support to the then-current movement toward a trust foundation

26. The Wall Street Review, Jan. 26, 1975, at 10, col. 1.

27. The Wall Street Review, Feb. 17, 1975, at 13, col. 4.

28. 161 N.Y. 78, 55 N.E. 388 (1899).

29. *Id.* at 80, 55 N.E. at 389.

for the control philosophy—in its paraphrase of the prototypical control case of 1856, *Sugden v. Crossland*:³⁰ “So, where a trustee retired from the office in consideration that his successor paid him a sum of money, it was held that the money so paid must be treated as a part of the trust estate, and that the trustee must account for it as he could make no profit directly or indirectly from the trust property or from the position or office of trustee.”³¹ The 1940 federal case, *Insuranshares Corporation v. Northern Fiscal Corporation*,³² had a similar view of the matter:

The defendants have insisted throughout the case that the transfer . . . was simply a sale of stock, the passing of control being merely a normal concomitant, and most of their argument was based upon this premise. This view, however, I think is fundamentally wrong. If the whole record be read, I do not see how the transaction can be considered as anything other than a sale of control, to which the stock sale was requisite, but nevertheless a secondary matter.³³

Thus the *Insuranshares* court would countenance no such deal between the contrôleurs. “The buyers were primarily interested in getting control of the corporation together with such stock ownership as would make that control secure and untrammelled, and the sellers were primarily interested in getting as much money as possible for what they had to sell—both the control and their interest in the assets.”³⁴ A year later *Gerdes v. Reynolds*³⁵ in New York confirmed *Insuranshares*: “Neither can they accept pay in any form or guise, direct or devious, for their own resignation or for the election of others in their place.”³⁶ Expectably the Second Circuit in *Perlman v. Feldmann*³⁷ reprobated the control premium:

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. . . . But when the sale necessarily results in . . . unusual profit to the fiduciary . . . he should account for his gains.

∴
The case will therefore be remanded to the district court for

30. *Sugden v. Crossland*, 65 Eng. Rep. 620 (Ch. 1856).

31. *McClure v. Law*, 161 N.Y. 78, 81, 55 N.E. 388, 389 (1899).

32. 35 F. Supp. 22 (E.D. Pa. 1940).

33. *Id.* at 24.

34. *Id.*

35. 28 N.Y.S.2d 622 (Sup. Ct. 1941).

36. *Id.* at 651.

37. 219 F.2d 173 (2d Cir. 1955). For a thorough analysis of this famous case, see Bayne, *The Sale-of-Control Premium: The Disposition*, 57 CALIF. L. REV. 615 (1969).

a determination of . . . the value of defendants' stock without the appurtenant control³⁸

That was in 1955. By 1964, the *McClure* tradition was still vigorous. In that year the Court of Appeals of New York affirmed the Supreme Court's pungent analysis of the sale-of-control premium in *Caplan v. Lionel*:³⁹

When the transaction is stripped of its somewhat complicated facade, what was originally offered by Cohn, and in turn subsequently offered for sale by Defiance, was Cohn's power which later became Defiance's power . . . to "persuade" seven out of ten of the board of directors of Lionel to resign in favor of the designees of any prospective purchasers of such power.

Clearly, such power alone was the commodity here being bartered to the highest bidder in the marketplace.⁴⁰

The celebrated *Lionel* opinions⁴¹ are probably the best modern spokesmen for this antipolar extreme. *Ferraioli v. Cantor*,⁴² a 1967 federal case, and both *Brown v. Halbert*⁴³ and *Jones v. Ahmanson*⁴⁴ in 1969 in California follow the *McClure* tradition.

But the convictions at the other pole are equally categorical. An early instance out of many again came from New York in the fascinating *Stanton v. Schenk*⁴⁵ in 1931 (Mr. Nicholas Schenk just recently deceased was one of the "leads" in a true-life drama featuring Marcus Loew of the theatre chain, his widow, William Fox of Fox Theatres, and MGM). As with *McClure*, *Schenk* issued a forthright statement of the question:

Essentially the sole proposition in this case is 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 corporation⁴⁶

The answer was equally forthright and equally contra *McClure*:

No one will argue that the holder of a large block of the stock

38. 219 F.2d 173, 178 (2d Cir. 1955).

39. 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1964).

40. Matter of Lionel Corp., 151 N.Y.L.J. at 14, col. 3, at col. 5 (Feb. 4, 1964).

41. *Id.*, *aff'd sub nom.*, Petition of Caplan, 20 App. Div. 2d 301, 246 N.Y.S.2d 913, *aff'd mem.*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964). *Gabriel Indus., Inc. v. Defiance Indus., Inc.*, 151 N.Y.L.J. 13, col. 8 (Sup. Ct. June 17, 1964) (Serafite, J.), *aff'd mem.*, 23 App. Div. 2d 630, 260 N.Y.S.2d 180 (1965), *modified*, 22 N.Y.2d 405, 239 N.E.2d 706, 293 N.Y.S.2d 65 (1968).

42. 281 F. Supp. 354 (S.D.N.Y. 1967).

43. 271 Cal. App. 2d 307, 76 Rptr. 781 (1969).

44. *Jones v. Ahmanson*, — Cal. App. 2d — (1969).

45. 140 Misc. 621, 251 N.Y.S. 221 (1931).

46. *Id.* at 216, 251 N.Y.S. at 229.

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 the 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.⁴⁷

In 1960, in *Manacher v. Reynolds*⁴⁸ Chancellor Seitz sitting as the Court of Chancery of Delaware confirmed the *Schenk* court when he endorsed the position of a Reynolds' "expert witness, Mr. Brandi, president of Dillon, Reed & Co., Inc., a well known investment house."⁴⁹

"A. I think control of a corporation is practically always worth more than the market value of an ordinary share.

"Q. Have you formed any opinion as to how much more?
A. Well, I believe that you could readily obtain forty to fifty million dollars in excess of break-up value for the rights to control Reynolds Metals.

"The Court: Just to be explicit, when you talk of this value, it is a value to whom?

"The Witness: Value to a willing buyer, buying from a willing seller. . . . [S]omeone who would want to go into this business and buy control of it."⁵⁰

The lower court in *Feldmann* was unabashedly clear: "It is obvious, I think, that some at least of the specific applications of the power [of control] have inherent value effective to enhance the value of a control block of the stock."⁵¹ Judge Nordbye in *Honigman v. Green Giant Company*⁵² in the District Court of Minnesota has taken probably the most unequivocal stand of all: "No Class A shareholder could be expected to forego the power of control of a company of this size without receiving in return a consideration commensurate with the value of the control which he foregoes."⁵³ One year later, 1962, the Second Circuit in *Essex Universal v. Yates*⁵⁴ carried forward the tradition. "There is no question of the right of a controlling shareholder under New York law normally to derive a premium from the sale of a controlling block of stock."⁵⁵ In the most recent and most direct confrontation, the Tenth Circuit in the 1969 case of *McDaniel v. Painter*⁵⁶ fully endorsed *Christophides*

47. *Id.* at 216, 251 N.Y.S. at 223.

48. 39 Del. Ch. 401, 165 A.2d 741 (1960).

49. *Id.* at 420, 165 A.2d at 752.

50. *Id.*

51. *Perlman v. Feldmann*, 129 F. Supp. 162, 184 (D. Conn. 1952).

52. 208 F. Supp. 754 (D. Minn. 1961).

53. *Id.* at 758.

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

55. *Id.* at 576.

56. 418 F.2d 545 (10th Cir. 1969).

*v. Porco*⁵⁷ and thus summarized the apparent trend. Federal District Court Judge Pollack in 1968 in *Porco* could not have been clearer:

Even assuming that Fasco realized a premium for its controlling block, that alone would not entitle plaintiffs to relief. *Essex Universal Corp. v. Yates*, . . . *Manacher v. Reynolds* These cases hold that a majority or controlling stockholder is under no duty to other stockholders to refrain from receiving a premium upon the sale of his stock which reflects merely the control potential of that stock. There is no obligation under such circumstances to "share and share alike."⁵⁸

But probably the loudest voice and the most impressive authority is Judge Swan of the Second Circuit in his forceful dissent in *Feldmann*: "Concededly a controlling block of stock has greater sale value than a small lot."⁵⁹ In response to the majority's remand "for a determination of . . . the value of defendants' stock without the appurtenant control" ⁶⁰ Judge Swan elaborated his position:

The controlling block could not by any possibility be shorn of its appurtenant power to elect directors 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.⁶¹

So, seemingly, are the two warring camps drawn up against each other. This ambivalence in the law of corporate control is frustratingly summarized in a single mugwumpian sentence in *Lionel*.

Nor may controlling stockholders receive a bonus or premium specifically in consideration of their agreement to resign and install the designees of the purchaser of their stock, *above and beyond the price normally attributable to the control stock being sold*.⁶²

Thus is the scene set for the answer to Mr. Rikling's questions.

57. 289 F. Supp. 403 (S.D.N.Y. 1968).

58. *Id.* at 405.

59. *Perlman v. Feldmann*, 219 F.2d 173, 180 (2d Cir. 1955).

60. *Id.* at 178.

61. *Id.* at 180. A legal writer supports Swan:

The control potential of a large block of shares has a value, and equalizing per-share prices is simply interfering with the market forces determining the value of control. As the price of control blocks is raised in this artificial fashion, fewer "purchases" of control will occur. Many shareholders will simply receive no premium at all for their shares—a high price to pay for shareholder equality.

Manne, Letter to the Editor, *The Wall Street Journal*, Nov. 5, 1969, at 22, col. 6.

62. *Matter of Lionel Corp.*, 151 N.Y.L.J. 14, col. 3, at col. 4 (Feb. 4, 1964). (emphasis added).

"Is the price paid in reality a price paid for the stock, or is it, in part at least, a price paid for the resignations of the existing officers and directors and the election of the buyer's nominees?"⁶³ And, if 'a price paid for the stock,' does the right rest in Rikling and Jarneen to set such price without regard to the market of the 87-percent minority?

The answers will be approached in a *Prelude* and four parts: (I) *Contrôleur Increment and True Investment Value*, (II) *The Disqualification of the Contrôleurs*, (III) *The Solution: The Tender Offer*, (IV) *The Legal Consequences of a Sale*.

THE PRELUDE

The gradual evolution of the philosophy of corporate control has been speeded considerably by meticulous definition of the major control concepts.⁶⁴ Fuzziness can ruin an analysis. An initial chore, therefore, must be the isolation by precise delineation of each of the two concepts fundamental to the present study: (1) *The Legitimate Transfer of Control*, (2) *The Sale-of-Control Premium-Bribe*.

(1) THE LEGITIMATE TRANSFER OF CONTROL

The point of reference for any recondite control problem logically should be the simple control transfer, unencumbered by the complexities of premiums over market, subtle investment-value factors or devious camouflages of collateral consideration. In a word, the ancient *reductio ad absurdum* inevitably facilitates comparison with involved variants and hybrids.

Just such an apposite *reductio* was the unassuming transfer in 1964 of Weyenberg Shoe⁶⁵ from Patriarch Weyenberg—at age 82, founder, director and contrôleur for all of the firm's 58 years—to Thomas W. Florsheim, young, in his midthirties, "vigorous, and with nearly five years experience as vice-president of the Florsheim Division of International Shoe . . ." ⁶⁶ As contrôleur, Weyenberg was acutely conscious of his fiduciary

63. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 653 (Sup. Ct. 1941).

64. Bayne, *The Definition of Corporate Control*, 9 ST. LOUIS U.L.J. 445 (1965); Bayne, *The Sale-of-Control Premium: The Definition*, 53 MINN. L. REV. 485 (1969), reprinted in 11 CORPORATE PRACTICE COMMENTATOR 139 (1969).

65. Bayne, *A Legitimate Transfer of Control: The Weyenberg Shoe—Florsheim Case Study*, 18 STAN. L. REV. 438 (1966) [hereinafter cited as *Weyenberg*].

66. *Id.* at 440.

duties to his highly successful company, realizing full well that the destiny of Weyenberg Shoe lay cupped in his own two hands—through his family and himself he controlled exactly 51.3 per cent of the company's stock.⁶⁷ He further recognized that such absolute custody⁶⁸ carried the imminent obligation to seek out and appoint the best possible successor to the office of *contrôleur*. All other of his corporate acts were as nothing compared to this choice of a new man for the top job. His sole concern: Successor suitability.

Mr. Weyenberg had been early convinced that "Florsheim possessed all the requisite leadership qualities, from a prestige name and social acceptability to managerial competence and moral integrity."⁶⁹ Further to the point, "[t]he death of R. J. Dempsey had left the firm bereft of a president, with no discernible heirs to the leadership."⁷⁰

But how effect the control transfer? Especially, how could Florsheim be assured of untrammelled control in the face of numerous Weyenberg relatives and the 51.3-percent Weyenberg block?

The solution came in a dissipation of the shares. Approximately 2,050 public shareholders already held 431,821 shares of common, the remaining 48.7 per cent of the Weyenberg stock. If this dispersal were increased substantially, the control of Weyenberg Shoe would shift from a 51.3 per cent "democratic majority" to a "mere-incumbency" control through the domination of the proxy statement.⁷¹

Just such a dispersal was effected through the secondary offering of 222,725 shares of the Weyenberg family stock. This left a 23.2-percent block in Mr. Weyenberg and the bulk, 73.8 percent, scattered across the nation among thousands of shareholders.⁷² Florsheim thus became *contrôleur* of Weyenberg Shoe.

"To give stability and permanency to his affiliation, Florsheim further agreed to invest 600,050 dollars in the company through the purchase of 27,275 shares of common stock at twenty-two dollars per share."⁷³ On the two days prior to the agree-

67. *Id.*

68. See Bayne, *Corporate Control as a Strict Trustee*, 53 GEO. L.J. 543 (1965).

69. *Weyenberg*, *supra* note 65, at 440; Bayne, *The Sale of Corporate Control*, 33 FORDHAM L. REV. 583, 593 (1965).

70. *Weyenberg*, *supra* note 65, at 439.

71. *Id.* at 440.

72. *Id.* at 441.

73. *Id.* at 440.

ment Weyenberg Shoe closed at 22-7/8 on the American Stock Exchange.⁷⁴

In the secondary offering the price to the public was \$24.25 per share, with \$22.80 the proceeds to the selling shareholders (the last reported Amex sale on October 14, 1964, was \$24.375). Thus Florsheim, at \$22.00 exactly, paid an amount slightly lower than the going market and less than the \$22.80 received by Weyenberg and his associates after deduction of underwriting discounts and commissions from the public price.⁷⁵

Mr. Weyenberg without more had simply sold some 27,000 of his own shares at market, undoubtedly conscious, even overly conscious, of the trust relationship he bore through the firm to the many members of his family and the public, who assuredly would be shocked at any bonus over market. Note well, moreover, only one assumption will give legitimacy to the Weyenberg-Florsheim stock sale: That the price paid was in effect set by the impartial public fully informed of Florsheim and his potential for the future of Weyenberg Shoe.

The Weyenberg-Florsheim transfer was just as simple as that. No beclouding factors hid the essentials from view. Contrôleur Weyenberg appointed Florsheim his successor, and incidentally sold him three percent of Weyenberg Shoe at market.

(2) THE SALE-OF-CONTROL PREMIUM-BRIBE

Perhaps the most advanced development in the philosophy of corporate control has come in the area of the *illegitimate* sale of control.⁷⁶ If anything is clear—and it clearly is not the legitimate investment-value rationale—it is the sale-of-control premium-bribe. Segregate and understand this concept and success in understanding the investment value of control stock is largely assured.

The early sale-of-control cases, *McClure*, *Porter v. Healy*,⁷⁷ *Gerdes v. Reynolds*—the progenitors of *Feldmann*, *Lionel*, *Ferraioli v. Cantor*, *Brown v. Halbert*, *Jones v. Ahmanson*—offered utter simplicity of facts, and resultant clarity of law. Outstanding of these is *Gerdes v. Reynolds*.

Single-handed the Reynolds (Metals) family have been prolific of voluminous control litigation. Their first assay into the

74. *Id.* at 449.

75. *Id.*

76. Bayne, *The Definition*, *supra* note 64, at 485; Bayne, *The Sale-of-Control Premium: The Intrinsic Illegitimacy*, 47 TEXAS L. REV. 215 (1969).

77. 244 Pa. 427, 91 A. 428 (1914).

barter of control came in late 1937 with the sale down the river of their own Reynolds Investing Company, Incorporated. (In a similar ploy some 20 years later they were successful,⁷⁸ but in *Reynolds* they got caught.)

Three Reynoldses (and a factotum by the name of Woodward) were the sole officers and directors of this small investment trust. "They were also stockholders, and, with members of their families, owned a majority of its common stock, which was the only stock having voting power and was junior to debentures and preferred stock outstanding in the hands of the public."⁷⁹

A rather nondescript syndicate of ill-defined numbers headed by Sartell Prentice of the brokerage firm of Prentice & Brady cast covetous eyes on the liquid portfolio of Reynolds Investing. After complicated, even confusing, negotiations over many weeks the Reynolds family unloaded their entire interest in the firm, some 1,055,000 shares, for the stunning (as will be seen) price of \$2 per share.⁸⁰

As the event would have it, John Gerdes, trustee in bankruptcy, instituted an action "to hold accountable therefor both those who sold and those who bought."⁸¹ Justice Walter of the Supreme Court, New York, in a lengthy opinion concluded:

In this case, however, it indisputably was a condition of the sale that all the officers and directors then in office should forthwith resign and that under their power to fill vacancies they should forthwith elect an entirely new directorate chosen wholly by the purchaser of the stock⁸²

Moreover, "Neither can they accept pay in any form or guise, direct or devious, for their own resignation or for the election of others in their place. *McClure v. Law* . . . ; *Bosworth v. Allen*"⁸³

At this point the New York court faced up to the question of segregating the premium-bribe from the investment value of the block: "Is the price paid in reality a price paid for the stock, or is it, in part at least, a price paid for the resignations of the existing officers and directors and the election of the buyer's

78. *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741 (1960).

79. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 629 (Sup. Ct. 1941).

80. *Id.* at 631.

81. *Id.* at 630.

82. *Id.* at 651.

83. *Id.* See also *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163 (1901). The illegality of a premium for control alone has been treated in Bayne, *The Noninvestment Value of Control Stock*, 45 IND. L. J. — (1970).

nominees?"⁸⁴ In his answer Justice Walter weighed the relevant factors in stock evaluation and summarized his position.

Viewing all the elements which the fiduciary obligations of the officers and directors of Reynolds Investing Company required them to view I am convinced that \$2,110,000 was so grossly in excess of the value of the stock that it carried upon its face a plain indication that it was not for the stock alone but partly for immediate en masse resignations and immediate election of the purchasers' nominees as successors. The transaction was not one in which there was merely a sale of stock, with the right to elect directors passing to the purchasers as a legal incident of the sale⁸⁵

The court personally was convinced that six cents per share—not \$2—should be the "maximum asset value of the shares."⁸⁶ But for slightly specious reasons an "additional something" was allowed "because of permissible hopes and expectations and other considerations already mentioned."⁸⁷ With that Justice Walter disposed of the matter:

It nevertheless is a matter of fact which the trier of facts must find, and with due allowance for all elements I think that 75 cents per share is as liberal a finding as the evidence warrants. That gives \$791,250 as the price paid for 1,055,000 shares of stock and \$1,318,750 as the price paid for the resignations of the officers and directors and their election of the buyer's nominees as their successors, or, in other words for what is termed the turning over of control.

The conclusion ordinarily to be drawn from the foregoing is that, having violated their fiduciary duty, these officers and directors must account to the corporation . . . for the sum of \$1,318,750⁸⁸

And that was the very conclusion that the court reached. As will be seen, Justice Walter failed to carry the reasoning far enough, but his total effort was commendable, especially for his times.

The Premium-Bribe Analyzed

Arguably and in practical effect the court, with *McClure*, "treated this transaction as a bribe paid to the directors."⁸⁹ Step by step through page after page the New York court deftly reasoned to all the essential elements of that *McClure* sale-of-control premium-bribe. The congeries of these essential elements

84. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 653 (Sup. Ct. 1941).

85. *Id.* at 658.

86. *Id.* at 655.

87. *Id.* at 658.

88. *Id.* at 658-59.

89. *McClure v. Law*, 161 N.Y. 78, 80, 55 N.E. 388, 389 (1899).

leaves only one conclusion, that the \$1.3 million—\$1.25 per share over market—was

(1) some form of consideration monetary or otherwise, (2) flowing to the incumbent *contrôleur*, (3) from or on behalf of the prospective *contrôleur*, (4) to induce the appointment to the office of control, (5) paid knowingly, *scienter*.⁹⁰

This, of course, is the technical definition of the sale-of-control premium-bribe.

What the court did not spell out—understandably so in the early year of 1941—was the underlying rationale for the illegality of this premium-bribe.⁹¹ Undeniably, the court founded its decision on the correct philosophical base. “Officers and directors always and necessarily stand in a fiduciary relation to the corporation and to its stockholders . . .”⁹² However, a long line of arduous and involved reasoning lies between this broad fiduciary duty and the \$1.3-million award to the corporation. But this arduous line nonetheless was clearly traced, albeit subliminally, throughout the court’s analysis. Necessarily, all three essentials—perversion of judgment, illicit compensation, unsuitable successor—were there.

Perversion of Judgment

First and foremost, throughout the opinion the court continually adverted to the Reynoldses’ specific fiducial obligation to scrutinize closely the personal suitability of their appointees, to guarantee honest and competent successors. The court further knew that any money under the table was illicit, that such emolument belonged to the corporation, not to the Reynoldses. “Neither can they accept pay in any form or guise, direct or devious, for their own resignation or for the election of others in their place.”⁹³ The violation of these two principles spelled only one thing: perversion of judgment. Once determined to leave the firm, the Reynoldses had only one norm governing their appointment, the suitability of the successor. At that charged moment in the beginning when they undertook the custody of Reynolds Investing, they also dedicated themselves unreservedly to the *bonum commune* of the company, especially in that most important official act of all, the appointment of a new *contrôleur*.

90. Bayne, *The Definition*, *supra* note 64, at 497.

91. Bayne, *The Sale-of-Control Premium*, *supra* note 76, at 223.

92. Gerdes v. Reynolds, 28 N.Y.S.2d 622, 651 (Sup. Ct. 1941).

93. *Id.*

Full in the face of this sole norm of *contrôleur* conduct they turned their back on the corporation—and any thought of successor suitability—and founded their judgment of selection on considerations of cold cash. In a word, here was a \$1.3-million (at least) perversion of judgment in the appointment of Prentice to the control of Reynolds Investing.

Syllogistically: (1) The suitability of the successor is the sole final cause that may flow legitimately into the selection of the new *contrôleur*. (2) The consideration of the premium-bribe is totally irrelevant, foreign, antagonistic to suitability. (3) Yet the premium-bribe consideration does flow as a final cause into the selection of a successor. Here is the quintessence of the perversion.⁹⁴

Illicit Consideration

But the illegitimacy of the premium-bribe does not stop with the perversion of the *contrôleur*'s judgment. Even beyond this, the Reynolds family accepted, even demanded, \$1.3 million for a corporate act, the most important of their corporate career, performed "in fulfillment of a corporate duty, in the course of official business, during the regular workweek, for which [they were] already amply remunerated."⁹⁵ The acceptance and the attempted retention of this \$1.3 million was in and of itself a second distinct element of the total turpitude of the premium-bribe. Here was illicit emolument that rightly belonged to the corporation. Here, moreover, was the direct rationale for the court's award of the \$1.3 million to the corporation.

Successor Unsuitability

Thirdly and most subtly, and a point which seemed to flicker in the back of the court's head, was the last coconstituent of the overall illegitimacy of the premium-bribe. The Reynolds family knew full well that the Prentice group were bribers, men (1) prepared to pervert the Reynolds judgment to the tune of \$1.3 million, and (2) prepared to pay this illicit cash not to the corporation but to faithless servants. Knowing all this the Reynoldses were nevertheless determined to foist such unsuitable men on the hapless firm. Thus, premium-bribe-induced unsuitability was also a factor in the illegality.

The amalgam of these three elements is the essential turpitude of the premium-bribe.

⁹⁴, Bayne, *The Sale-of-Control Premium*, *supra* note 76, at 223.
⁹⁵. *Id.* at 235.

This tripartite illegitimacy could be described as (1) the perversion of the judgment of the incumbent contrôleur, engendered by an appointment of a successor induced by a cause other than suitability, (2) that is, for consideration illicit in itself, (3) resulting in the appointment of a candidate unsuitable by reason of his own role in the inducement.⁹⁶

Set off against the legitimate control transfer of Weyenberg Shoe, *Gerdes v. Reynolds* can serve as the archetype of the illegitimate sale—illicit dollars improperly paid to the contrôleur to premium-bribe an unsuitable successor into the office.

(I) CONTRÔLEUR INCREMENT AND TRUE INVESTMENT VALUE

With these two antithetical prototypes so stark and clear—one patently legitimate, the other not—what must be said of the elusive and unidentified *tertium quid*? Judge Swan—and certainly Victor Rikling—had something else in mind beyond the simple transfer of control without bonus or markup, and surely not the bald premium-bribe of *Reynolds*. Prescinding from the pro or con, what are the basic factors—and what are not—that contribute to the presence of a legitimate investment value in a “control” block of stock? Before arguing to its legitimacy, first define it precisely, then view the definition from every reasonable angle.

One further admonition is in order. For the present, prescind further from the later, and completely crucial, question of who has the ultimate right—the negotiating contrôleurs, the market, the minority shareowners—to establish “the investment value” of the “control” stock. For now, simply define what it is. For later, the who is to evaluate, how, and under what rules.

Technically defined:

The Legitimate Investment Value of Control Stock is the total current worth of that stock, (1) resultant on the superadded contribution of the estimable abilities of a new contrôleur to (2) the existent corporate entity.

Toward understanding this elusive concept, one surpassing truth can summarily brush away a long series of misconceived premises. A new man with fresh and different talents has just succeeded to the top spot in the corporate hierarchy. This appointment is nothing other than a transfer of control, and this transfer has brought a new set of assets to the firm. The increment referable to the qualities of this new contrôleur—the new

96. *Id.* at 222.

value a new *contrôleur* adds to the otherwise-unchanged corporation—is the all-important element in the investment value of control stock. Here is the preeminent fact in the concept.

Thus certainly this new value is not related to a *sale of control, the barter of the office*, which entails a premium-bribe and is intrinsically illegitimate. The value does not lie in control as such, but rather in the totality of the abilities the new man brings to the firm. The possession of control merely facilitates the exercise of the talents. The totality of his suitability is the differential between the value of the corporation before and after arrival, under a former control *vis à vis* a new control. "Control" was always present. New talents made the difference. A direct ratio persists between these abilities and the investment value of the control stock.

A second source of distortion has been the use of the term "control stock." The implication would seem to be that the investment value is limited *exclusively* to the control block. To the contrary, the accession of the new *contrôleur* benefits the entire entity and correspondingly enhances equally the value of all the stock outstanding—including, incidentally, the "control block."

The explanation of this usage of "control block" is not difficult to discern. Although the increment to the entity attributable to the special talents of the new *contrôleur* is not peculiarly related to the "control block," nonetheless an accidental connection often exists between the new *contrôleur*—the party responsible for the increment—and the stock. It often happens—and outstandingly so in control litigation—that the successor *contrôleur* purchases a stock block from the incumbent at the time of the appointment. The price set for this "control stock" reflects for the first time the increment to the entity resultant on the new man's worth.

Correctly expressed, therefore, the investment value, enhanced by the appointment of the new man, is prorated equally to all stock of the entity—including, of course, but not exclusively, the "control block" as well. Merely because the owner of the "control block" happens to be the new *contrôleur* does not mean that that stock is any more valuable per share than the stock owned by anyone else, whether he be the outgoing *contrôleur* or a minority public holder. In short, the investment value is unrelated to who the owner is, and hence unrelated to the "control block" as such. In fact, ownership as a relevant

factor would be ignored completely were not some owner, any owner, necessary.

Thus Judge Swan in his *Feldmann* dissent—"Concededly a controlling block of stock has greater sale value than a small lot"⁹⁷—was not only misleading, but probably never meant what he said. Judge Swan certainly would never condone a premium-bribe:

A director is privileged to resign, but so long as he remains a director he must be faithful to his fiduciary duties and must not make a personal gain from performing them. Consequently, if the price paid for Feldmann's stock included a payment for voting to elect the new directors, he must account to the corporation for such payment, even though he honestly believed that the men he voted to elect were well qualified to serve as directors. He cannot take pay for performing his fiduciary duty.⁹⁸

Yet Judge Swan equally definitely recognized a "greater sale value" in "a controlling block of stock." How maneuver the Judge between this Scylla and Charybdis? The maneuver is a statement of what the Judge really meant, and an enunciation as well as the perspective proper to understanding the true nature of the investment value of "control" stock:

A "controlling block of stock" (or any other block) sold (or not sold) by the outgoing contrôleur (or by anyone) to his appointee (or to anyone) has "greater sale value" than "a small lot" (or any lot, including the "controlling block") had before the accession of the talented new contrôleur.

Furthermore, this proposition stated in question form would be the exact and technical question—the first of the two—that Mr. Rikling asked when Mr. Jarneen handed him \$3.45 million over market: Does the "control block" have an intrinsic and legitimate value considerably greater than a similar block without control?

The answer to Mr. Rikling's question and to Judge Swan's quandary should supply a new set of legal principles fundamental to the philosophy of corporate control.

THE ELEMENTS OF THE SHARE VALUE

Toward the explication of Judge Swan's statement—as rewritten—recur to the basic Rikling-Jarneen facts. First adapt them slightly to present purposes, and later use them as they were.

The time as before is March of 1973. The scene is the same.

97. *Perlman v. Feldmann*, 219 F.2d 173, 180 (2d Cir. 1955).

98. *Id.* at 179.

Mr. Rikling atop the Tribune Tower discerns the same gloomy panorama stretching back over Mythical Rikling's fiscal 1972. The presage is there. As a "Youngstown source said . . . 'Mr. Rikling became 72 last December. He has expressed on numerous occasions the desire to liquidate much, if not all, of his holdings and take it easy.'" And again, being a sensible man, Mr. Rikling had determined to do just that.

Again, being also a conscientious man, Mr. Rikling undertook a thorough search for a suitable successor as *contrôleur* of Mythical Rikling. His first selection did not measure up, or at any event aborted. Unfortunately, "[o]n Feb. 29 Alabama-Atlantic . . . called off merger talks with Mythical Rikling." But in his second effort Mr. Rikling found his Florsheim in Norton Jarneen. In him, one could conjecture, were all the "personal qualities required of the corporate *contrôleur* . . . (1) moral integrity; (2) intellectual competence; (3) managerial and organizational proficiency; (4) social suitability; and (5) satisfactory age and health."⁹⁹ With this selection Mr. Rikling had satisfied his trust obligation to Mythical Rikling.

But at this point the script varies. Conceive rather that Messrs. Rikling and Weakly had over recent years slowly sold off their 13-percent block of stock. *Ex hypothesi*, therefore, MRST shares were completely dispersed. No single shareholder owned more than three percent and Mr. Rikling himself had none. His was the merest of mere-incumbency control, but with all the stability of A. T. & T., thanks to the wide dispersal and his firm grasp on the proxy-solicitation mechanism.

As for Norton Jarneen, he was an empire builder much in the mold of a Muscat, a Riklis or a Ling. He wanted no stock, only the opportunity to put his unparalleled abilities to work for Mythical Rikling. With the meeting of the minds the deal was sealed and the appointment made, with nary a share changing hands. As *Insuranshares* would put it, "[E]verything they did [was] done without their owning more than directors' qualifying shares."¹⁰⁰ The *seriatim* replacements were perfunctory.

The obvious upshot? The consensus of informed buyers and sellers, established by the reasoned judgment of the Street, would shortly respond to Mr. Jarneen's appointment by sending the market in Mythical Rikling, for example, to 25.

99. Bayne, *supra* note 69, at 593.

100. *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22, 24 (E.D. Pa. 1940).

THE PERSON IS THE VALUE

This variation on the original Mythical Rikling facts should illustrate one principal point. The arrival of a supercontrôleur can enhance overnight the value of all stock equally—without any sale whatsoever, whoever the owner. The only requisite: The transfer of control, the appointment of a new contrôleur.

From the particular aspect of the share value, the crux of the problem lies with the personal qualifications of the successor contrôleur. The differential between a corporation before and after is the sole distinguishing element. At Mythical Rikling this overnight differential lay between Victor Rikling and Norton Jarneen, between \$18 and \$25 per share.

At this point a new technical term could well be introduced into the argot of corporate control:

Contrôleur Increment is the increase in value of all stock of a corporation referable exclusively to the proven abilities of a new contrôleur—the differential between the contributions to corporate value of the outgoing and incoming contrôleur.

This *contrôleur increment* alone distinguishes the investment value of “control stock” from the same block prior to the advent of the new contrôleur. Bearing forcefully in mind all the precautions of *The Prelude*, it is fascinating to read Judge Hincks’ mind between the lines of *his* analysis of the contrôleur increment in the lower-court *Feldmann*:

For instance, to the usual minority stockholder in a corporation the value of his stock necessarily depends on earnings which in turn depend on the abilities of its management. But one considering the purchase of a control block in a corporation may give less weight to past earnings since, if a change in management might be beneficial, the power to make such a change is in his hands. Thus, where the purchaser feels that the corporation’s past record does not adequately reflect its realizable possibilities, he may well feel justified in paying more than the quoted market price for a control block of its stock, on the theory that the present price probably has been determined in large measure by the corporate earnings under the old management. Surely this power through stock control to improve the corporate performance may be a factor of value attaching to a control block of stock.¹⁰¹

Whether the new contrôleur is to be an Ernest Breech, a Lynn Townsend, a Roy D. Chapin, Jr., or rather a Louis Wolfson, a Lowell Birrell, an Eddie Gilbert, will be the sole intrinsic determinant of the contrôleur increment and correspondingly of the investment value of the “control block.”

101. *Perlman v. Feldmann*, 129 F. Supp. 162, 184 (D. Conn. 1952).

How does the market discern these personal capabilities of a Breech or a Birrell? What are the guidelines for the evaluation of this sole essential of *contrôleur* increment?

The discernment of the *contrôleur* increment—and more important its isolation for evaluation—is not overly difficult. After all, the corporation itself necessarily remains unchanged during the accession of the new *contrôleur*, since the appointment obviously can occur only at a single instant in time. Any differential must be referable to the new *contrôleur*'s talents. In such clear isolation the *contrôleur* increment is readily estimated, and the norms for estimation are simple and obvious.

The Nature of the Firm. As competent an empire builder as a Jarneen may be, his abilities—and hence the resultant *contrôleur* increment—must be related to the circumstances he faces. Thus in the 1956 New York case of *Benson v. Braun*:¹⁰²

It is trite but true to say that each corporation whose stock is evaluated must be viewed in relation to the facts peculiar to that particular enterprise. In this case factors were present which could well have been taken into account and have led to establishing a selling price well above the market quotations on the corporation's one listed stock.¹⁰³

Even a Rader-Carr would not be invaluable to a Reynolds Investing in the dismal months of late 1937. Who today would dare pretend to add any *contrôleur* increment to General Motors? The current state of the nation, the economic bent of the government, the prospects for the industry, the health or infirmity of the firm itself, all form the milieu in which the new *contrôleur* exercises his talents. The scope for corporate improvement deeply affects *contrôleur* potential.

Far from the least of the factors to be considered in assessing possibilities for growth value is that of management. Moreover, the type of business in which this corporation was engaged is a matter of importance. In the search for reasons to explain the apparently high price paid for controlling stock, it is proper to inquire whether there were distinctive features of the corporation which might influence a purchaser to pay such price.¹⁰⁴

Past successes, proven ability, vast experience can all be brought to naught—or enhanced—by these influences. *Contrôleur* increment, therefore, will fluctuate with the adaptability of the material at hand and the climate of the environment.

An Informed Market. A key cause for confusion in the

102. 8 Misc. 2d 67, 155 N.Y.S.2d 622 (Sup. Ct. 1956).

103. *Id.* at 71, 155 N.Y.S.2d at 627.

104. *Id.* at 72-73, 155 N.Y.S.2d at 628.

evaluation of *contrôleur* increment has been the failure to distinguish the value of MRST shares under Rikling, for example, and the wholly new MRST plus Jarneen. The market of MRST during the entire period prior to the public announcement of Jarneen's accession could be lower, or higher, than the market afterwards. More to the point, sufficient time must elapse—witness the court's treatment of the same problem in *Texas Gulf Sulphur*¹⁰⁵—for the informed public to assimilate the various effects the Jarneen control will have on Mythical Rikling. *Until all factors necessary for a reasoned judgment have sifted down*, the new market for MRST-plus-Jarneen is not a true norm of the *contrôleur* increment. Remember above all that the market for MRST-plus-Rikling may have little relation to the MRST-plus-Jarneen market. In fact they could be far apart: By mid-1974, the Rikling 18 had fallen to a Jarneen 11-3/4.

In the end, the free competitive market—able buyers with their own money on the line—is the unimpeachable norm. The market price of a listed stock reflects the full impact of Wall Street—securities analysts, investment advisers, industry specialists, market experts—as well as the “willing seller, willing buyer” criterion. In fact, the considered judgment of the money-in-hand investor would be the reliable distillate of all other value indices.

This detailed disquisition on the existence and nature of *contrôleur* increment—even to the canonization of a new term—was eminently necessary. Granted, the concept has a relatively limited use and would appear rarely outside the specific context of a sale of control. Such circumscribed utility would scarce warrant such attention had not a long line of Swans,¹⁰⁶ Lumbarbs¹⁰⁷ and Pollacks¹⁰⁸—and a conjecturally longer line of Riklings and Jarneens—taken refuge in the blind of “true investment value” of a “control” block of stock. “True investment value” has long been a ready rebuttal—in fact, the last such possible rejoinder—to a charge of premium-bribery. And “*contrôleur* increment” is the heart of “true investment value.”

As long as the Swans, therefore, continue to see a “greater

105. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

106. *Perlman v. Feldmann*, 219 F.2d 173, 180 (2d Cir. 1955) (Swan, J., dissenting).

107. *Essex Universal Corp. v. Yates*, 305 F.2d 572, 576 (2d Cir. 1962) (Lumbard, C.J.).

108. *Christophides v. Porco*, 280 F. Supp. 403 (S.D.N.Y. 1968) (Pollack, D.J.).

sale value" in "a controlling block of stock" and the Riklings persist in thus justifying questionable private sales, one must thoroughly define their position, if only to reject it out of hand.

The first of Mr. Rikling's questions has thus been answered, although not perhaps in the full affirmative he expected. A "control block"—or any block—may have an enhanced value resultant on the accession of a new *contrôleur*, the *contrôleur* increment. It should be clear, however, that the term "control stock" is in truth a misnomer.

CONTRÔLEUR DECREMENT

But stop momentarily. This entire scrutiny of "true investment value" saw only the rosy half. "*Contrôleur decrement*" is a far more realistic factor, especially when a Wolfson or a Birrell buys control. An incumbent *contrôleur* may be desperate to retire—through financial pressure, incompetence, age, ennui—and equally desperate in his selection of a successor. Thus, perhaps, the overnight value of MRST under Jarneen was really 11 instead of 25. Maybe the market at 18 for MRST-plus-Rikling was far too high for the new MRST-plus-Jarneen. In all the foregoing pages, therefore, also read "*contrôleur decrement*" and paint the picture black. In every future scrutiny always ask as well if "*contrôleur increment*" is not in truth "*decrement*," and the investment value that much less. "*Contrôleur decrement*" is undoubtedly the more important contribution to the control lexicon.

And now, what of the more crucial, second Rikling-Jarneen question: Who has the right—the two *contrôleurs*, incoming and outgoing, the minority 87 percent, the market—to determine the amount of the *contrôleur* increment—or *decrement*—and hence the true investment value of the "control block?" Or more to the point, who may act on such an evaluation in a good hard dollars-and-cents sale of that block? The answers to this multipronged question will form the second part of this inquiry into the investment value of control stock.

II. THE DISQUALIFICATION OF THE CONTRÔLEURS

Return now to the original Mythical Rikling facts. Retrace each step from the first moment when Victor Rikling determined to resign as *contrôleur*. But pause for a moment at the events immediately after Mr. Rikling's selection of Mr. Jarneen as his

successor. Segregate conceptually the various stages of the negotiations between the two.

At the conclusion of Mr. Rikling's search, and his decision that Mr. Jarneen embodied every requisite of *contrôleur* suitability, the question naturally arose: What of the Rikling 13-percent block? Should he sell it? After all, with Jarneen in control the shares could be worth \$25 and that was an appreciable increment over the recent market of \$18. But if sell it, to whom? Perhaps the public? Or Val Florian? Or possibly even Mr. Jarneen himself? Further, reasoned Mr. Rikling, a complete severance from Mythical Rikling, stock and all, might be the gentlemanly approach. Even further, the best interests of Mythical Rikling might dictate a sizable stock ownership in the new *contrôleur* himself. Mr. Rikling undoubtedly recalled the sentiments old man Weyenberg expressed somewhat formally in his contract with Florsheim:

Whereas Florsheim, having substantial experience in the business of manufacturing and selling shoes, is willing to undertake the responsibilities of directing the business and affairs of the Company in such manner that the ends required by Weyenberg are achieved, and *in connection therewith*, wishes to acquire a substantial equity interest in the company¹⁰⁹

As for Mr. Jarneen he shared these thoughts thoroughly, adding a secret surmise that his control position—founded, it is true, on the proxy and the dispersal—would certainly not be less secure with that 13-percent block in hand, rather than the oral, albeit unquestionable, assurances of Mr. Rikling, or even an unassailable voting-trust certificate in his pocket.

With such unanimity of attitude, agreement was readily reached. Mr. Jarneen was to have his 13-percent block. But now what? Could Rikling sell Jarneen his own 13 percent forthwith? If so, at what price? The market had hovered around 18, but both Rikling and Jarneen were convinced—or so it would seem—that the *contrôleur* increment resultant on Jarneen in office actually lifted the value to 25. The two *contrôleurs* faced the most vexing of questions: Who is to name the price? Could they personally set it at 25, and close the sale accordingly?

If ever everything could not be said at once, it is at this moment when the simultaneous conjunction of several seemingly disparate factors crowds the mind and defies all orderly progress. But each of these factors can be put in place. And as each is so arranged, the result becomes an arresting revela-

109. *Weyenberg, supra* note 65, at 448 (emphasis added).

tion, especially to Messrs. Rikling and Jarneen, and any other sale-negotiating *contrôleurs*. The orderly conjunction of these factors spells out forcefully the essential illegality of any private evaluation of the *contrôleur* increment or decrement by the two *contrôleurs*, outgoing and incoming. As a guide for ready reference, a formal statement of this illegality would perhaps help toward tracing the line of argumentation:

At the time of the transfer of control and the sale of the "control" stock inter se, a personal evaluation of that stock—whether correct or not—by the two contrôleurs, incumbent and appointee, is intrinsically reprobate under the benefit-to-beneficiary and no-inquiry rules, since both contrôleurs are acting throughout as strict trustees of the entity.

This technical enunciation of the major thesis set for proof should meet head-on the second of the Rikling-Jarneen questions.

STRICT TRUSTEES

At this point little doubt should remain about the *potential* existence and reality of a marked, dollar differential in value between a Mythical Rikling under Rikling and the same corporation moments later under a Jarneen. As for Rikling and Jarneen they set this overnight *contrôleur* increment at \$25 million, a \$3.45-million premium for the 13-percent "control" block. Less sanguine investors might have seen, to the contrary, a \$25-million *contrôleur* decrement, with the true market at 11. No naysayers can gainsay either potential. The question, therefore, is not the possibility of some *contrôleur* increment or decrement, but the right and conditions of determining it.

In this direct attack on the personal evaluation by Rikling and Jarneen, the pervasive philosophical premise, the ultimate rationale—sufficient with little more—is the custodial concept of corporate control.¹¹⁰ In assuming the stewardship of Mythical Rikling, Victor Rikling promised unqualifiedly all his "time, energy, imagination, judgment and skill"¹¹¹ to the well-being and benefit of the corporate entity. As a strict trustee he was bound firmly by the benefit-to-beneficiary rule. Beyond his agreed compensation, no recompense whatsoever could pass to Mr. Rikling for his transfer of the corporation to Mr. Jarneen. He was "bound to forego any emolument of any kind connected with the trust corpus. The very hypothesis of a trust relationship is the benefit-to-beneficiary rule."¹¹² As for

110. Bayne, *supra* note 68.

111. *Id.* at 571.

112. Bayne, *The Definition*, *supra* note 64, at 510.

Mr. Jarneen, he too, had undertaken the duties of a strict trustee. Thus, "at that charged instant when control passes from *contrôleur* to appointee, the complete custody of the corporation hangs precariously in the grasp of each, the one relinquishing, the other assuming."¹¹³ Both had identical obligations.

THE TRANSFER AND THE SALE

The first of two highly operable facts along the line of argumentation is the consummated appointment of a new *contrôleur*. No public announcement has yet been made, but Rikling has irrevocably selected Jarneen as the new steward of Mythical Rikling. For all practical purposes complete custody of the corporation has already passed into Jarneen's hands. Into these hands has been entrusted the corporate *bonum commune*, the future well-being of the entire entity.

The second operable fact has absolutely no *intrinsic* connection with the first. Whether Victor Rikling is to resign as *contrôleur* of Mythical Rikling, no matter. Merely because Rikling has appointed Jarneen his successor, also no matter. In any case and irrespective of the transfer of control, for reasons peculiar to each, Rikling has decided to sell and Jarneen to buy the 13-percent block of "control" stock. Either the control transfer or the stock sale could have been effected separately, the one without the other.

This essential dichotomy between control transfer and stock sale is the key to understanding the entire transaction. If Rikling were to force Jarneen to buy his 13 percent as a condition precedent to the appointment, any attempt to relate the \$3.45 million to the stock would be laughable. Both Rikling and Jarneen must staunchly live or die with one assumption: The appointment of Jarneen was made on merit alone, was a *fait accompli*, had absolutely nothing to do with any stock, or a premium over market, or the payment to Rikling of \$3.45 million in *contrôleur* increment. With any other assumption Rikling and Jarneen would be skewered on one prong or the other of a very painful dilemma. Either Rikling appoints Jarneen for merit alone, and nothing more, especially nothing more connected with control-stock dollars, or Rikling wants something more for Jarneen's appointment than Jarneen suitability, which by definition is premium-bribery. The appointment goes with the merit, the dollars go with the stock. Rikling and Jarneen, therefore,

113. *Id.*

must treat the valuation and sale of the stock in utter, albeit conceptual, isolation from the conceptually prior appointment. Any other treatment is disastrous.

THE 50-PLUS-PERCENT BLOCK

This essential severability may be readily understandable when the control stock is a minority interest, but the mind boggles a bit at the prospect of a majority-block sale. When the incumbent *contrôleur* owns 50-plus percent of the stock, would not a transfer of control *necessarily* entail the simultaneous sale of the control block? Are not the appointment of the successor and the stock sale inseparable when the control is actually attached to the stock? To the contrary, the presence of a majority-stock block alters none of the basics. The same fundamental principles govern the selection of the successor, his appointment and the transfer of control. One accidental difference, however, is the understandable cause for hesitation.

In most of the hypotheticals thus far adduced, the control position of the *contrôleur* was founded on nondemocratic mere incumbency, the wide dispersal of shares and the domination of the proxy-solicitation mechanism. The shift to a majority-stock-ownership control base only changes one thing, the manner—but not the essentials—of the control transfer. Mr. Weyenberg faced this problem in his appointment of Florsheim, since he owned 51.3 percent of Weyenberg Shoe. He and Florsheim solved the situation not by an outright sale of the block to Florsheim but by a secondary offering to a widely dispersed public. Thus, even with a 50-plus-percent block, the sale itself is unrelated—or related only accidentally—to the transfer of control. The transfer is the appointment; the sale is collateral at most. Any of the standard control devices—pooling agreement, proxy coupled with an interest, voting trust—can achieve the same objective. Or, of course, the sale of the control block. The sale is merely one of many means of effecting the appointment, but in no wise the necessary one.

Although the transactions are essentially unrelated and independent—as the two *contrôleurs* must steadfastly aver—nevertheless Rikling and Jarneen have decided to join the two (which is the invariable case in any but the most bold-faced sales of control). The simultaneous appointment of a new *contrôleur* and the sale of a substantial stock block to the appointee by the very person appointing melds these two *intrinsically disparate*

acts into a *practically indivisible unit*. Any realistic view of the circumstances makes it impossible to consider one facet without the other. The two deals are extrinsically inextricable. Future argument assumes this inseparability.

Another valid assumption would eliminate, and correctly so, from the Mythical Rikling hypothetical any other collateral transactions that might divert attention from the control-transfer/stock-sale exchange just now conjoined. Were a substantial lump sum to have passed¹¹⁴—admittedly unconnected with the stock sale—from Jarneen to Rikling, a rebuttable presumption of premium-bribe presence¹¹⁵ would become immediately operative and put the parties on the defensive. Many explanations for such a premium are possible, but few are convincing. Jarneen could have taken the occasion of his appointment to pay off a long overdue \$3.45-million Rikling debt. Or perhaps express the depth of his respect and regard for Mr. Rikling in a gracious gift in a similar amount. Either of these—debt payment, gracious gift—could for some valid reason, or pure fortuity, accompany the transfer of control, and thus rebut the presumption. But fortunately for the instant investigation—since such an analysis belongs elsewhere¹¹⁶—no such bald bonus has intruded into the hypothetical facts. For the present, therefore, the single unencumbered control transfer/stock sale stands alone for scrutiny. No dollars other than the price for the stock need disturb the concentration.

OVERVALUATION: A PREMIUM-BRIBE

With the control transfer and the stock sale all alone in the spotlight, the looming importance of the evaluation takes its proper perspective. Absolutely the only money involved is the \$13 million Jarneen paid Rikling for the stock. No spurious bonuses—debt, gift or whatever—cloud the issue. Any chicanery that might be afoot, therefore, must lurk in these stock-sale dollars, or it is nowhere. If a premium-bribe is to be laid at the Rikling-Jarneen doorstep, it can be found in only one place, the amount fixed as the investment value—was there *contrôleur* increment or rather even decrement?—of the “control” block.

114. See *McClure v. Law*, 161 N.Y. 78, 55 N.E. 388 (1899), *Porter v. Healy*, 244 Pa. 427, 91 A. 428 (1914), *Gabriel Indus., Inc. v. Defiance Indus., Inc.*, 151 N.Y.L.J. 13, col. 8 (Sup. Ct. June 17, 1964).

115. Bayne, *The Definition of Corporate Control*, 9 ST. LOUIS U.L.J. 445, 507-15 *et seq.* (1965).

116. *Id.*

With this comes the crux. An *overvaluation*, however little or much, becomes necessarily a bald premium-bribe paid by Jarneen to Rikling for his appointment to the office of control. "Overvaluation" by definition denotes the deliberate appraisal of a saleable object at a figure *over* its true value. Such an appraisal entails perforce the purposeful attribution of dollars in excess of honest worth. Any such dollars, therefore, beyond the value of the stock by inexorable logic have no connection with the stock. They represent money passing from appointee to incumbent with no justifiable relation to the stock sale.

Since the Rikling-Jarneen deal is indivisible, any excess dollars not referable to the stock value are willy-nilly referable to the control transfer. No other explanation is possible. Unless, of course, one wishes to indulge in the overdue-debt, gracious-gift gambit (But then why secrete the debt or gift in the stock value?). The same inexorable logic would then describe, equally necessarily, such excess dollars in only one way: The price to be paid for control, the primitive premium-bribe.

With this the circle is complete. Even the slightest, deliberate overvaluation satisfies by that very act the five requisites of the illicit premium-bribe. Here unmistakably would be (1) palpable consideration (2) destined to flow from would-be *contrôleur* Jarneen to (3) incumbent Rikling (4) to induce the appointment—since no other explanation was proffered—to the office of control of MRST. As astute businessmen both Rikling and Jarneen (5) knew full well, *scienter*, what they were doing.

TRAFFIC IN THE TRUST

Concede for the moment that two such putative *contrôleurs* did deliberately overvalue the "control" block in order thus to camouflage a \$3.45-million¹¹⁷ sale of control. Carry out this assumption, strictly *arguendo*, to its logical limits. Would such a control sale, particularly the overvaluation deeply embedded in the deal, be the official act of two corporate agents performed pursuant to their *contrôleur* duties, or a completely independent transaction between two private parties acting in their own personal capacities? Would that control-transfer/stock-sale exchange, and the overpricing essential to it, be a proper—here

117. Recall that this \$3.45 million figure is extremely tentative. Should later analysis conclude to *contrôleur* *decrement*, \$3.45 million would be correspondingly too little.

improper—function of the trust office, or merely a collateral business deal between two individual entrepreneurs?

The sale of control can be disguised behind many masks. In *Laurenzano v. Einbender*,¹¹⁸ the premium-bribe was tucked away in the sale of a subsidiary at “an excessive price.”¹¹⁹ In *Caplan-Lionel*¹²⁰ appointee Sonnabend was prepared to approve a \$75,000 outlay in the form of consultation fees to the former *contrôleur*, the Muscat group. In *Porter v. Healy*,¹²¹ to the contrary, all duplicity was eschewed with a naive lump-sum payment.

Merely because the sale of control hides behind the stock-investment-value subterfuge in no way alters its essentials. The very heart of the act remains the conscious transfer of the custody of the entire trust corpus from incumbent to appointee. Concomitant, but nonetheless integral, to this transfer is the payment of a price for the appointment, in this case a price established by the overestimation of the value of the corporation as allegedly enhanced by the advent of a Jarneen and the departure of a Rikling. This overvalued *contrôleur* increment or overlooked decrement correspondingly inflates falsely the price for the “control” stock, thereby passing the premium-bribe. This bipartite act involves simultaneously and inextricably the transfer of custody and the personal overvaluation of the entity.

Once one adopts the stock-investment-value ploy as a sale-of-control device, and the overvaluation thereby becomes a necessary constituent of the premium-bribe. And the premium-bribe of course is the essence of the sale of control. Victor Rikling, continuing *arguendo*, would never have considered the Jarneen appointment without the prior assurance of the premium-bribe, and consequently without the overvaluation as the vehicle to carry the cash. And Norton Jarneen would never have joined in the overvaluation—and thereby parted with otherwise unnecessary and unrelated dollars—were not excess dollars prerequisite to an appointment untrammelled by the uncomfortable strictures of appointee suitability binding a legitimate transfer of control.

A congeries of related functions, therefore, combines to produce one indivisible act, the transfer of custody for a price. As such, this multifaceted act—the mock valuation of the stock,

118. Bayne, *supra* note 115, at 503.

119. *Id.*

120. 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1964).

121. 244 Pa. 427, 91 A. 428 (1914).

the payment of the premium-bribe, and the sale of control—is the most important of all official corporate transactions. Here are two strict trustees performing a complex but single corporate act, in their official capacities, on corporate time, for the avowed good of all, pursuant to the mandates of their office, and involving directly the entire trust corpus, the corporate entity. This sale of control is not a strictly private matter between two independent businessmen, and therefore regulated by the loose rules of the marketplace. Rather such transfer of custody is subject in all its details to the utmost stringencies of trust law, particularly the benefit-to-beneficiary and no-inquiry rules. The sale of control, through overvalued stock, is truly trafficking in trust assets, and is governed accordingly. Were one, therefore, to indulge in the supposition of a purposeful overvaluation to effect a premium-bribe, the result would necessarily be traffic in the trust, and the consequent imposition of strict trust rules.

One might argue that the *overvaluation* alone is essential to trafficking in the trust, that an exactly correct evaluation would remove the premium-bribe and the corresponding sale of control, that a mere sale of stock, divorced completely from the transfer of custody, would remove the applicability of the trust rules. This is specious. The two form a moral unit. Even if divination—and certainly no human agency could work the wonder—could reveal nothing but *contrôleur* increment in the dollars for the stock, the concatenation of stock sale and custody transfer would produce the integral act of traffic in trust assets.

Note well, moreover, that all this is not airy persiflage. These benefit-to-beneficiary and no-inquiry rules bind grim and specific application to the *ad hoc* situation at hand. Such possible *contrôleurs* are not strict trustees in a vague academic sense, bound by ivory-tower generalities. They are face to face with exact rules geared to a highly particular trust context: A sham overvaluation in order to buy custody of a corporation.

CONFLICT OF INTEREST

In its broadest statement the custodial concept of corporate control stipulates that a corporate steward guard, guide and nurture the beneficiaries' assets without benefit to self. In his month-to-month, year-to-year administration the *contrôleur* must strive for the best possible corporation in terms of management, corporate structure, personnel. If possible, a *contrôleur's* duties

heighten at that critical second when he entrusts the entity to a new steward. If ever, then does the benefit-to-beneficiary rule come into play. But more to the point, when a *licit* control transfer is transformed into an *illegitimate* sale for a price measured in overvalued stock, the benefit-to-beneficiary rule correspondingly adapts to the occasion.

Faced with the twin *possibility* of (1) diversion of illicit dollars from the corporate till, and (2) the appointment of an unsuitable *contrôleur*, the corporate custodian finds his obligation triply specified: (1) He must be a vigilant *representative* of the beneficiaries' interest. (2) His representation must extend to *all* without exception. (3) The utmost *impartiality* must be his rule. The *contrôleur* has been entrusted with "other people's money." Although he may hold 13 percent of the entity himself, as did Rikling, he nonetheless must represent the "other" 87 percent with the same evenhandedness as his own. This 87 percent, or 100 percent, or 0.01 percent—even the mite is much to the widow—is entitled to equally impartial treatment.

Yet at this trust-charged instant the two custodians are locked in an excoriating conflict of interest. Behind closed doors is the bargaining table. At one end sit a Rikling and Jarneen, two strict trustees, avowedly dedicated only to the stockholders' interest. At the far other end sit two level-eyed entrepreneurs, the same Rikling and Jarneen (If Pooch Bah could do it, why not they?) impelled by only one personal desire: To extract the best possible deal from themselves as trustees. With an eye to the dollar these two gentlemen as astute businessmen wish only to outmaneuver themselves as custodians. The interests are antipolar. But wherein lies the substance of the conflict? What, for example, would a Rikling and Jarneen want that would be so inimical to the 87-percent public?

THE PUBLIC INTERESTS

Were the MRST minority represented at the bargaining table their desires would have been simple indeed, reducibly twofold: (1) The elimination of a premium-bribe (say \$3.45 million? Or more?) by means of an honest stock evaluation, and (2) The appointment of a suitable *contrôleur* (say a Jarneen?).

Since any overpricing of the stock becomes *eo ipso* a premium-bribe, and since the premium-bribe money goes invariably into the pocket of the incumbent *contrôleur* (when it rightly

belongs to all equally¹²²), the minority 87 percent wants above all a very vigilant eye at the valuation. Every extra dollar is simply larceny from the corporate safe. To the contrary, if the stock valuation is correct, no premium-bribe will pass and the shareholders are cheated of nothing. Here is the benefit-to-beneficiary rule in elementary application: No premium bribe dollars may pass to trustees at the expense of beneficiaries. Such illicit cash is one of the coconstituents of the triple turpitude of the premium-bribe. Were the public minority, therefore, assured of impartial scrutiny of the dollar assessment of the stock, half their wishes would be met.

But more than half the battle would be won for the minority if impartial evaluators succeed in eliminating the premium-bribe. Without the inducement of premium-bribe dollars the deliberate appointment of an unsuitable *contrôleur* is understandably unlikely. Remove the pressure of possible overpricing, even to the extent of \$3.45 million or beyond, and Victor Rikling would assay the suitability of his appointee with an eye single to personal qualifications. Obviously and necessarily the premium-briber would thereby be eliminated from contention for the office. The readiness—perhaps indicative of a propensity¹²³—to premium-bribe his way into control is a principal element of the unsuitability of any prospective *contrôleur*. This very act of premium-bribery would seem to disqualify any candidate for the custody of others' assets.

The addition, moreover, of premium-bribe-induced unsuitability to the illicit cash would supply the second constituent of the triple turpitude of the premium-bribe. The third requisite would come with the appointment itself. Thus use of over-valued stock to conceal the cash does not create any new species of premium-bribe. The result is the same tripartite illegitimacy which "could be described as (1) the perversion of the judgment of the incumbent *contrôleur*, engendered by an appointment of a successor induced by a cause other than suitability, (2) that is, for consideration illicit in itself, (3) resulting in the appointment of a candidate unsuitable by reason of his own active role in the inducement."¹²⁴

Once, however, the impartial scrutiny of a third party fore-

122. Bayne, *The Sale-of-Control Premium: The Disposition*, 57 CALIF. L. REV. 615 (1969).

123. It is further submitted that a premium-briber generally recoups his outlay at the expense of the corporation.

124. Bayne, *The Sale-of-Control*, *supra* note 76, at 222.

stalls a premium-bribe, the assumption is justified that the incumbent *contrôleur* is trustworthy enough to adhere closely to the fivefold norm of successor suitability: "(1) moral integrity; (2) intellectual competence; (3) managerial and organizational proficiency; (4) social suitability; and (5) satisfactory age and health."¹²⁵

THE CONFLICTING INTERESTS

Set off against these legitimate shareholder expectations are the deeply antagonistic goals of the trustees-turned-entrepreneurs. When two such competing entrepreneurs join battle over the amount of the premium-bribe lodged in the stock valuation, neither battler is worrying about the public minority.

Of the two, perhaps the conflict of interest is more glaring in the incumbent *contrôleur*. After a Rikling has decided to sell the office for overpriced stock, he obviously will fight tenaciously—else why enter the arena in the beginning?—for the highest possible overpricing. With the market at 16 to 20, why should a Rikling settle for 22 if he can force the bid to 25 (or 26.5 as Val Florian did)? For the premium-bribed, the top dollar is the only sensible course.

With this approach, one might think the seller is the primary, even the sole, villain in the script. After all, he not only selected the successor but he sold the office. Perhaps even pushed the matter, since he exacted the premium-bribe. Most of all, he has actually pocketed the putative premium-bribe, possibly even more than the \$3.45 million. To the contrary, in an arm's-length negotiation between two hard-headed entrepreneurs the prevailing assumption would cast both in the identical roles of equals, one as able to take care of himself as the other. The success of such a deal postulates mutual agreement. It takes two consenting parties to make a bilateral contract. Even more, the would-be *contrôleur* is the active party. He wanted the office. He would do the premium-bribing, and might well have been the instigator. European Import Companies wanted steel (MRST), iron ore and ships (Chicago-Slopes) to fill out the pattern for "the development of a total system for the domestic and international transportation and distribution of freight."¹²⁶ This was, after all, "transition year plus one"¹²⁷ for European Import. Thus a Jar-

125. Bayne, *The Sale of Corporate Control*, 33 *FORDHAM L. REV.* 583, 593 (1965).

126. European Import Companies, Inc. Annual Report, at 3 (1968).

127. *Id.* at 1.

neen will pay a Rikling or a Florian whatever it takes to buy control, especially since premium-bribe dollars obviate any inquiry into suitability. Not that unsuitability is the objective, but at least suitability is not the sole norm. This is the prevailing point for Jarneen. No need now to buy more stock. Or get the approbation of 51 percent of the owners. Dollars not merit are now the issue. If merit alone were involved, Rikling would never demand overvalued dollars, or would Jarneen think of paying them. On merit alone Jarneen never would have gotten the job. Else why the overpayment? Rikling obviously wanted more than Jarneen, or his talents. And Jarneen wanted less than the shareholder scrutiny in a democratic election. Reflection reveals that both parties are equally guilty, since both are equally responsible. Both are strict trustees. One received the money, but the other passed it. If a Rikling was premium-bribed, a Jarneen was the premium-briber. Rikling and Jarneen, therefore, formed a united front in their antagonism to the interest and welfare of the 87 percent. One sought premium-bribe dollars. The other, other than suitability. Toward the minority they were a single unit of opposition.

To this would come a strong Rikling-Jarneen rebuttal in the Swan tradition: "Concededly a majority or dominant shareholder is ordinarily privileged to sell his stock at the best price obtainable from the purchaser."¹²⁸ If Rikling is determined to get the "best price obtainable" and Jarneen the lowest, who is to say that such an arm's-length struggle is not as objective as any other competitive market? Jarneen's suitability is beyond question. Concededly his appointment on merit alone has been consummated. Why must the two delay to seek the bids of others? Especially since no one knows the product better than Rikling and Jarneen.

The pitched battle over the investment value is not difficult to imagine. Rikling might begin higher, but probably would soon settle firmly and finally at 25. In support of his price he would simply detail Jarneen's proven success in building European Import into an "international transportation"¹²⁹ colossus, with acquisitions and subsidiaries stumbling one over the other—Regional Materials Services, Western Despatch, Federal Truckloading, MRS'T, Chicago-Slopes Iron, Flat Stone Iron Mines, Bonus Pig, Sea Pond Hatcheries, the Inequity Corporation

128. *Perlman v. Feldmann*, 219 F.2d 173, 179 (2d Cir. 1955) (Swan, J., dissenting).

129. *European Import Companies*, *supra* note 126.

and others.¹³⁰ (In a surge of modesty Rikling might even cite his own team's recent failures.) Jarneen would be loath to gainsay the *contrôleur* increment he would bring to Mythical Rikling.

But the dollar sign would restore sanity and Jarneen would counter with the undeniable and pervading presence of the ready market of the NYSE—some two-million-share turnover in seven months—at the arresting reality of 18. To pay Rikling 25, or Florian 26.5 would be abject folly when he could lift the telephone and pay 18. Further, would not such a purchase at 25 be self-damning? Assuredly Mr. Jarneen, or any incoming *contrôleur*, could have no special predilection for Mr. Rikling's particular share of stock, especially when they carried a \$7 markup.

But before the phone is lifted Rikling presses some equally arresting facts. Should MRST-plus-Jarneen be really worth 25, or even 30 as both in their heart know, what of a forceful derivative suit under section 10(b) and rule 10b-5 by the minority, alleging, and justly so, failure to disclose the material fact of the true value of the public's shares enhanced by the Jarneen *contrôleur* increment? The litigation expense alone would eat up the saving, and recovery besides would not be unthinkable. In the same vein, Rikling evidences a tendency to jump the gun with an early announcement of the appointment, and watch the market go to 30 before Jarneen can buy. Jarneen reconsiders. With these possibilities 25 looks persuasive, as does section 10(b), or a possible 30 or more.

Of course, argues Jarneen, the Jarneen advent might mean *contrôleur decrement*, and therefore 15, or even 11-3/4. But the absurdity of this is apparent to both and the figure is firmed at 25.

This brief interlude, so the argument would go, is exactly reflective of any arm's-length negotiation between any two bargaining shareholders possessed of inside information of *Texas Gulf Sulphur* magnitude. *Contrôleur* increment may be the subject of an arm's-length deal. Or *contrôleur* decrement.

But all this is fantasy. One tends to wander off in a dream-world of stock-sale negotiations and forget the surrounding reality. These two are *not* Tom and Dick shareholders dickering over the price of the stock. If they were, the fantasy would be

130. European Import Companies, Inc. Notice of Special Meeting, in Lieu of Annual Meeting, of Stockholders, June 11, 1974 (May 9, 1974). This 100-page proxy statement gives a broad conspectus of the Jarneen empire.

reality. At this moment these two are *contrôleurs*, strict trustees, passing control of an \$85-million company. They are negotiating in the real world of a gross conflict of interest. Both are far more interested in the sale of control than the sale of the stock. The latter is incidental. Rikling and Jarneen, and Swan and Lumbard and Pollack, fail to emphasize that the stock sale can never be fully divorced from the transfer of custody. At that moment a Rikling can see premium-bribe dollars and a Jarneen a merit-free, voteless appointment to control. As long as a control transfer accompanies a stock sale, the stock sale is necessarily involved in traffic in the trust.

True, when Rikling and Jarneen sat down together, a knock-down-and-drag-out battle did ensue. But it was not an open, arm's-length negotiation between one dogged and impartial investor and another. To the contrary, one must assume that it was two tough-minded businessmen hammering out in private the amount of premium-bribe necessary to buy control of Mythical Rikling. To Rikling and Jarneen, the overnight *contrôleur* increment, with Jarneen in and Rikling out, adding instantaneously \$25 million to the overall worth of the Mythical Rikling Sheet and Tube Corporation and correspondingly netting Rikling \$3.45 million for his "control" block, was an artful ruse. Doubly artful if the increment was actually decrement. Such rather was the Rikling-Jarneen consensus of the sale value of control to a ready and willing premium-briber. Stock valuation was in fact premium-bribe negotiation. Otherwise, why not a competitive price on a free market?

The *Insuranshares* court knew what happened: "The buyers were primarily interested in getting control of the corporation together with such stock ownership as would make that control secure and untrammelled, and the sellers were primarily interested in getting as much money as possible for what they had to sell—both the control and their interest in the assets."¹³¹

THE NO-INQUIRY RULE

Note well: The sole subject of this back-room valuation was a totally unknown entity. Not a soul had any clear idea of the value of Mythical Rikling under a Jarneen. No one even suspected the combination was in the offing. True, the cold eye of the market had calculated Mythical Rikling under Rikling at an average 18. But Mythical Rikling-plus-Jarneen was presumably

131. 35 F. Supp. 22, 24 (E.D. Pa. 1940).

another thing. The *contrôleur* increment, or decrement, the differential before and after, was the lone subject of valuation, and not one person beyond Rikling and Jarneen had even heard of it.

Next, the valuation itself was strictly *ex parte*. Behind closed doors and alone Rikling and Jarneen upped Mythical Rikling's value \$25 million, by simply subtracting Rikling and adding Jarneen. No impartial person—a ready buyer with dollars in hand—was called in to put a price on the stock without control. No public announcement asked an objectively competitive market to evaluate Mythical Rikling-plus-Jarneen. Obviously, such an evaluation—whether by ready buyer, general market or even the 87-percent minority—would eliminate any conflict of interest. No longer would the valuation be that of Rikling and Jarneen. The competitive evaluation would become their evaluation. In effect this impartial third party would supplant Rikling and Jarneen, acquisitive entrepreneurs, at the bargaining table. Then Rikling and Jarneen, strict trustees, would be out of the conflict.

But the doors were never thus opened, and the valuation of this questionable increment was strictly a private matter. No outside scrutiny, no current corroboration, no possible double check. To this add the dedicated devotion to their own interests, a palpable conflict of interest, and Rikling and Jarneen have set the scene for the unswerving application of the no-inquiry rule.

Over the decades the Anglo-Saxon law of trusts has gained some remarkably reliable insights into man's nature and conduct. Paramount among these has been the categorical conviction that a fallible human person on both sides of a bargain with a personal stake in the outcome is essentially incapable of impartiality. Centuries of legal wisdom have long since placed such detached objectivity far beyond the rational powers of *homo rationalis*. This ultimate principle of human conduct is founded simply on the consistent fragility of human nature.

Age-old recognition of this basic handicap of acquisitive man led inevitably to the formal enunciation of the so-called no-inquiry rule:

The law of trusts has been unrelentingly adamant in the automatic disqualification from any attempt to represent both sides in an adversary negotiation of any single person with a personal interest in one side. So unremitting is the prohibition that the courts will not even initiate an inquiry into the result.

The absolute inflexibility of the no-inquiry rule is amply

justified by the fusion of two separate factors: (1) The private evaluation of a wholly unknown subject with no independent corroboration, (2) by a single person with interests deeply in conflict with those of the absent party. Understandably the result is automatic disqualification.

Further reflection can penetrate more deeply into the rationale of the no-inquiry rule. When a Rikling and Jarneen, trustees-turned-entrepreneurs and hence a unitary "person," personally priced a new entity—MRST with Jarneen—without the check of a free market, the result could be high of the mark, or low, or exactly reflect true value. From the strictly factual standpoint, Rikling and Jarneen could stoutly stand by \$25 million in *contrôleur increment*, whereas detractors among the public minority could argue vociferously that the transition from Rikling to Jarneen was rather a *contrôleur decrement* of \$25 million (witness a year later), that Jarneen was far from a Breech, Townsend or Chapin. *But both claims are equally irrelevant.* The nub is the intrinsic incompetency of a Jarneen to set a value on Jarneen, especially with help from a Rikling who wants the highest dollar. Whether high, low or exactly correct, therefore, is not the point. The real crux is twofold: (1) *The ever-present possibility of overvaluation*, and (2) *The utter impossibility of knowing what the correct value might have been.* The complete absence of a free-market countercheck plus the proven conflict-of-interest compulsion render the chance of overvaluation invariable. In the light of the cupidity of humankind such possibility is rather likelihood.

With such inescapable possibility—even likelihood—and the inability to ever know, the law is forced to regard such overvaluation as a certainty. Since the law can never depend on the absence of overvaluation, it must always assume its presence. A necessarily possible overvaluation must be viewed legally as an actuality. The conclusion: All private conflict-of-interest valuations are *legal* overvaluations, and must be treated as such in their legal consequences.

Such personal price-setting, then, is necessarily reprobate; not extrinsically because the figure could be correct (some *contrôleur increment* could well be present), but intrinsically because of the innate, conflict-of-interest disability and the postulated rejection of a competitive countercheck. The right itself is impugned, not the possible correctness of the evaluation. Any unsupervised valuation by partial parties necessarily becomes at law an overvaluation.

All this explains the assumption throughout that Rikling and Jarneen overvalued. Now at long last the validity, and necessity, of that irritating and long-prolonged "assumption strictly *arguendo*" of a Rikling-Jarneen mock valuation should be apparent. Such assumption is unavoidable, albeit regrettable, as long as partial parties insist on ignoring the independent market. What began as an assumption must end as a fact. Only thus can the law of trusts protect the helpless beneficiaries.

The view from the textbooks always left the no-inquiry rule looking harsh and unnecessarily unremitting. In the abstract, some concession seemed in order. But its applicability becomes vivid when a Rikling and Jarneen sit all alone pricing Mythical Rikling-plus-Jarneen at a figure personally congenial to both and smacking of a sale of control.

Thus the last of the several factors has been proven. As proven it joins with the others to prove the proposition originally set for proof:

At the time of the transfer of control and the sale of the "control" stock inter se, a personal evaluation of that stock—whether correct or not—by the two contrôleurs, incumbent and appointee, is intrinsically reprobate under the benefit-to-beneficiary and no-inquiry rules, since both contrôleurs are acting throughout as strict trustees of the entity.

Here then is the essential ineligibility, the necessary disqualification, of the trustees-turned-entrepreneurs. The no-inquiry rule interdicts absolutely any independent evaluation and sale.

But if Rikling and Jarneen are forever precluded from a private estimate, what to do? Is any sale possible? If so, how best?

(III) THE SOLUTION: THE TENDER OFFER

Victor Rikling was determined to resign. Painstaking research had produced a successor eminently suitable for the stewardship of Mythical Rikling. Norton Jarneen had acceded to the selection and was prepared to dedicate himself absolutely to the *bonum commune* of the corporation. The board change-over was settled. Mr. Rikling also felt, as Mr. Weyenberg before him, that the best interests of all, including Mythical Rikling, suggested that he unload his entire interest and quit the field completely. Besides, he was tired. And he wanted cash for his stock. So too did Val Florian.

Norton Jarneen on his part—better than any conscious of

his own capabilities—had estimated the value of his own personal contribution to the firm at \$7 per share. He was convinced that the *contrôleur* increment with Jarneen in and Rikling out was approximately \$25 million in all. More to the point Mr. Jarneen felt, as Mr. Florsheim before him, that a substantial stake in Mythical Rikling would give him greater incentive toward diligence and productivity. His current financial state indicated a 13-percent interest as feasible. He was determined to buy.

Both Mr. Rikling and Mr. Jarneen had only one all-pervasive consideration—the selection of a most suitable successor to the office of control. Certainly, no thought of a sale of control or a premium-bribe ever entered their heads. If, incidentally, Mr. Jarneen could also purchase a 13-percent block at \$25, all the better.

With both determined, one to sell, the other buy, several powerful impulses tortured them. How to rein in these forces, and still effect the sale and purchase to the satisfaction of both?

In the first place, Victor Rikling was frank to admit that he was not about to “perpetrate a Weyenberg” and sell at a market 18. And certainly he would never admit “*contrôleur decrement*” to 11 or more. He knew MRS'T-plus-Jarneen was worth 25. Jarneen had to agree, especially since he saw the real dangers of a section 10(b) action if he bought up 525,000 shares at 18 without disclosing his appointment. And a premature announcement *might* send the market to 30.

Next, as unlofty as the motive was, neither dared risk even the accusation of a premium-bribe. In their more moral moments they knew a private partial valuation came to just that. The sale/purchase had to avoid that stigma. Straight common sense, or even gross dollar-and-cents motivation, would send both incumbent and successor headlong to protect their names.

[O]f all the acts of his corporate career the most important is probably the *contrôleur*'s appointment of a successor, an act fraught with deep trust implications, determinative of the long-term future well-being of the corporation. How completely unthinkable and unlikely for men of prudence to pass unrelated consideration at this time. Even grade-school discretion would caution a contrary course. . . . [O]nly a rare trustee would not heed such grade-school warnings¹³²

The attitude of both Rikling and Jarneen would be colored deeply by strong desires to remove even the tincture of suspicion.

Finally, both Rikling and Jarneen translated their trust ob-

132. Bayne, *The Sale-of-Control Premium: The Definition*, 53 MINN. L. REV. 485, 510 (1969).

ligations into a firm desire to give the 87-percent minority an equal opportunity to share in any sale which would reflect the *contrôleur* increment or decrement effected by the advent of Jarneen.

Impelled by these desires, some altruistic, some selfish, but all legitimate, Rikling and Jarneen could well have thought of a way, a reconciliation of all the apparent ambivalence. The solution lay in a flanking operation. Oscar Wilde notwithstanding, the best way to overcome temptation is to flee it. Had Rikling and Jarneen wished to avoid the stigma of suspicion and the cries for an explanation, a simple sidestep would have achieved both. The risk of premium-bribe or section 10(b), the loss of a just sale or a fair purchase, the inequity of leaving the 87 percent outside, could all be obviated in the simplicity of an uncluttered tender offer.

A straightforward letter to all the shareholders over the signatures of Messrs. Rikling and Jarneen could squarely present all the facts and factors. The letter could begin with Mr. Rikling's decision to retire, his selection of Mr. Jarneen, a full but objective list of those Jarneen capabilities so impressive to Mr. Rikling, and move on to Mr. Jarneen's desire to buy into the firm. The letter could conclude with a firm Jarneen offer to purchase at \$25 per share—\$7 over current market—13 percent of all outstanding stock prorated equally for all, including, of course, Mr. Rikling.

Subsequent to the success of the offer and as part of the plan, Mr. Rikling on his part might possibly take immediate advantage of the \$25 market and sell—in paced sales over the NYSE—the remaining 87 percent of his original 13-percent block (but only after he had made up from his own shares any deficiency in the tenders, thereby assuring Mr. Jarneen of his full 13 percent). Thus in one simple flanking operation, Rikling and Jarneen would achieve their every objective, without even a smidgen of suspicion.

THE OUTGOING CONTRÔLEUR

Such a stratagem puts everyone on his mettle—Mr. Rikling particularly as incumbent *contrôleur*. His judgment of successor selection would be subjected to the collective scrutiny of an informed market. If the public shareholders of MRST concurred in Rikling's judgment of Jarneen's rosy promise, *none of the public 87 percent would sell*. Who would run away from a good

thing? Better keep the stock and ride high with Jarneen. Thus would Rikling's judgment be vindicated and his original intentions implemented. He would sell his entire 13-percent block to Jarneen and reap his full \$7 of *contrôleur* increment. And he could retire gracefully from the scene exactly according to plan.

To the contrary, if his vision had been blinded by an unfounded glamor in Mr. Jarneen, an astute evaluation of Mythical Rikling under Jarneen would send sell offers pouring in. And Mr. Rikling, able to sell only 13 percent of 13 percent, would be forced to live—or die—with 87 percent of his investment in the stewardship of Jarneen. (Jarneen might well wish to stipulate that such an event would prompt Rikling to disburse his shares on the market over an agreed period, and thus remove any discomfort Jarneen might feel in having his predecessor too close at hand.)

If Rikling's estimate was egregiously wrong in the eyes of the Street, if *decrement* rather than *increment* was the correct word, Mythical Rikling would invariably slip back down to the realistic 18 (or to the 11-3/4 it actually hit about a year after). With such sobering alternatives before him an incumbent *contrôleur* would not be hasty in either his selection of a successor or his estimation of *contrôleur* increment.

THE INCOMING CONTRÔLEUR

Except for the shared expense of the shareholder letter, such a tender offer should have considerable appeal to Mr. Jarneen. Even the relatively slight expense would be amply set off by the several advantages. First, he has achieved his prime objective—the opportunity to devote his talents toward the development of Mythical Rikling. As a result, his 13-percent block not only carries the present enhanced value of the *contrôleur* increment but the incentive of future appreciation under his aggressive leadership. Next, Mr. Jarneen certainly cared not a whit who sold him what particular shares (assuming the stipulation that Rikling later leave, if and when). With no intent of cheating anyone, he was perfectly ready to pay the fair price of 25—reflecting the legitimate *contrôleur* increment—to any seller ready to sell. But most of all, as an incipient trustee, Mr. Jarneen wanted to shun all taint of premium-bribery—and danger of section 10(b)—so easily done with a tender offer.

THE PUBLIC SHAREHOLDERS

The scattered minority have everything to gain. Granted, if the stewardship of Jarneen should go sour—presuming they held their shares—they would deeply regret Rikling's appointment. But even this contingency was freely chosen. They could have opted out, at least partially, at 25. This option to stay in or sell is far better than the forced acceptance of a new *contrôleur*. Further, the NYSE might momentarily follow the tender-offer price and the public might sell all their 87 percent at 25.

The tender offer gives the public holders the chance to realize their \$7 *contrôleur* increment on a prorata basis equal to the outgoing *contrôleur*. Such a trustee-*contrôleur* should not enjoy a favored opportunity to reap an early reward merely because of his position. This is one of the handicaps of being a custodian. Even then this handicap only holds the *contrôleur* to an equal price. The result is not a penalty, merely a bar to cheating. The offer was made to Rikling as incumbent *contrôleur*-trustee by Jarneen as incipient *contrôleur*-trustee. Thus does the tender offer anticipate the rudimentary demands of equity without the need of *postdelictum* litigation. As the California Court of Appeals puts it in the 1969 *Brown v. Halbert*:¹³³

The rule we have adopted here simply is that it is the duty of the majority stockholder-director, when contemplating the sale of the majority stock at a price not available to other stockholders and which sale may prejudice the minority stockholders, is to act affirmatively and openly with full disclosure so that every opportunity is given to obtain substantially the same advantages that such fiduciary secured and for the full protection of the minority.¹³⁴

The chief advantage to the public, however, lies in the knowledge that the steward of their assets will exercise every vigilance in selecting a suitable successor. The built-in safeguards will add realistic muscle to the *contrôleur*'s fiducial obligation to represent the dependent beneficiaries—and incidentally himself—in his successor selection and during an arm's-length negotiation of the investment price, including the *contrôleur* increment or decrement. And it would be truly arm's-length with

133. 271 Cal. App. 2d 252, 76 Cal. Rptr. 781 (1969).

134. *Id.* at 327, 76 Cal. Rptr. at 793-94. This same philosophy of "equal opportunity" has been produced within various contexts by several writers. See Jennings, *Tradings in Corporate Control*, 44 CALIF. L. REV. 1 (1956); Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965). The entire tender-offer approach assumes compliance with both the Williams Act and Rule 154.

the free market setting the price. Since the minority are at the mercy of the *contrôleur* in any event, far better to face the dangers of a control transfer with an option to bail out than to sit by and watch control pass to a looter or an incompetent. With a suitable appointee, moreover, the minority will not feel the necessity of selling their remaining shares.

This suggested solution is redolent of that Solomonic parental device for sharing the apple: One son cuts, the other chooses. With such an arrangement—and so too with the tender offer—the only unhappy party is the avaricious one.

Many possible variants could perhaps improve the plan. The prospective *contrôleur* could be required to purchase a minimum of 10- or 15-percent of the corporation. Or perhaps the outgoing *contrôleur* should not share in any sale to his successor until the public have tendered all they wish, up to the agreed limit.

But whatever the variant, obviously none of the proposals need be mandatory, even the tender offer itself. After the public announcement of the Jarneen appointment, several paths lay open. Rikling and Jarneen could have each bought and sold separately over the NYSE. Or they could have foregone a sale altogether.

But if Rikling and Jarneen insist on a sale *inter se*, only one narrow route is open: The price for the stock must be established by a freely competitive market—either general public or minority tender—with full knowledge of any potential *contrôleur* increment or, more to the point, decrement that Jarneen might bring to MRST. The crux? The market for MRST-plus-Rikling is strictly irrelevant to a new market for MRST with Jarneen. It may stay at 18, or go to 25, or 26.5, or 30—or drop to 11.

The ever-present possibility, therefore, of this ready-and-waiting freely competitive market in the persons of the public minority pushes the issue to the ultimate: Do the trustee *contrôleurs* intend the appointment of a suitable successor, accompanied incidentally by a legitimate sale and purchase of stock, or would they prefer a bald sale of control for a handsome premium-bribe?

But if that straight and narrow path of a tender offer is eschewed, what then?

(IV) THE LEGAL CONSEQUENCES OF A SALE

Were a court faced with a consummated sale along the lines

of the Mythical Rikling hypothetical, the devious path of reasoning so painfully elaborated thus far should point the way to a plausible adjudication.

The first step would strip away the camouflage that hid the traditional old-line premium-bribe. Underneath lay the blunt \$75 slipped under the table in *Sugden v. Crossland*,¹³⁵ the almost gauche \$15,000 Levy handed McClure,¹³⁶ the naive sale of control from Cohn to Muscat to Sonnabend for \$135,000 in straight cash in *Caplan-Lionel*.¹³⁷ The only difference? The dollars wore a different garb, and could barely be recognized in the "true investment value" of the stock.

To begin, the court would juxtapose (1) The transfer of custody of MRST from Rikling to Jarneen, against (2) The private sale at 25 by partial parties of an unknown entity, MRST-plus-Jarneen, untested, and never to be tested, by a free market, with not a thought of the 87-percent minority or any competitive bid. How remarkable that Rikling and Jarneen should choose the occasion of this most delicate act of their tenure for the sale of such a block at a price unconfirmed and unconfirmable.

In the face of such conflict of interest the no-inquiry rule would become immediately operative. How much of the \$13-million sale figure was pure premium-bribe? Was there contrôleur increment? Or decrement? No one would or could ever know. At the time of the actual sale no disinterested dollars were asked to bid against the partial price of 25. With that moment gone forever, steel shortages or steel glut, Viet Nam hopes or scares, franc devaluations or mark avvaluations, the baneful effects of inflation, the inflationary potential of SDRs—and, of course, the actual impact of Jarneen on Mythical Rikling—could send the market skyrocketing to 40, or plummeting, as it later did, to 11. All the paid appraisers in the world, with their own dollars inside their pockets, can never adequately reconstruct the true investment value of MRST shares as of March 26, 1973. The *Wall Street Journal* put it well in praising the German move to a free-floating mark:

The problem is: What is the mark worth? Instead of closeting some financial wizards to dream up the answer in a vacuum, the Bonn government chose to let the market decide. Specifically, it will permit the dollar-mark exchange rate to find its own level¹³⁸

135. 65 Eng. Rep. 620 (Ch. 1856).

136. 161 N.Y. 78, 55 N.E. 388 (1899).

137. 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1964).

138. The *Wall Street Journal*, Editorial, Oct. 1, 1969, at 8, col. 1.

In the end, then, a court would have no other choice: Secret traffic in the trust rendered the true value of the shares unknown and unknowable.

THE AMOUNT OF THE PREMIUM-BRIBE

At this juncture, therefore, the court would face the necessary chore: How determine the dollar amount of those shares? Jarneen chose to pay, and Rikling accept, 25, Florian, 26.5, in secret deals. After the open market absorbed the news of the Jarneen takeover, what was the available price? The dollar differential between price paid and price available will determine the amount of the premium-bribe.

But to say "dollar differential" only begins the chore. Dollar differential for whom? Were Rikling to have hunted an impartial buyer for his 525,000 shares, he would have cautiously sold on the Big Board over several months. He might have gotten as high as 27. Jarneen, however, would have been just as cautious and might have bought at 11. Whose efforts, Rikling's or Jarneen's, are to set the market price against the 25 actually paid? Rikling exacted the premium-bribe, but Jarneen was the premium-briber. Regardless of who is to be the protagonist, what conjectural price is to govern? The highest for Rikling? The lowest for Jarneen? In between?

Since two strict trustees saw fit to place themselves in a clear conflict with beneficiaries' interests, since both rejected the ready opportunity to get the best deal at competitive prices in a free market, since both refused at the proper time to establish the true dollar value of the stock, they cannot now complain when the court is forced to set the figure for them. Only thus can the law protect the neglected beneficiaries. In such an after-the-fact situation the court is willy-nilly hamstrung. It alone must find the price. More to the point, as between active malefactors and injured victims the court has little choice. The law must select that stock-price figure most favorable to the impotent minority and least so to the *contrôleurs* who concocted the deal and spurned an impartial price at the time. Learned Hand faced a similar problem in *Gratz v. Claughton*¹³⁹ in 1951: How to determine the profits in short-swing dealings when many sales and many purchases could not be matched with certainty.

The situation falls within the doctrine which has been law since

139. 187 F.2d 46 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951).

the days of the "Chimney Sweeper's Jewel Case" [*Armory v. Delamirie*, 1722, 1 Strange 505] that when damages are at some unascertainable amount below an upper limit and when the uncertainty arises from the defendants' wrong, the upper limit will be taken as the proper amount.¹⁴⁰

Learned Hand—and any court, it is submitted—would decide the instant question the same way. The only legal assumption available: The premium-bribe base would be the lowest price possible—within a reasonable time after the announcement of the appointment. Further, a Rikling-Jarneen court would in fact have an "ascertainable amount:" the best buy an energetic and dollar-minded Jarneen could find.

Not only must the court select the "upper limit . . . as the proper amount," but the time span for the purchase must extend as long as a reasonable buyer would wait. Nothing compelled Jarneen to buy privately on March 26. Had he or Rikling wanted immediate action a public deal or a tender offer was available. Jarneen could have spread his purchases over six months to a year, or longer, watching the market for the most favorable moment. Next to the tender offer itself the surest showing of honesty would have been just such a calculated delay till the objective market evaluated MRST-plus-Jarneen. In short, any "uncertainty [arose] from the defendants' wrong."

Thus the handicap the two *contrôleurs* assumed in refusing a free competitive offer would send the court to the lowest feasible figure within a reasonable time of the transaction. Such search would not be difficult. Roughly a year after the March 26 sale the market hovered for some time in the 13s, even hitting 11-3/4. On this basis the hypothetical \$7 would undoubtedly be supplanted by a more realistic \$12. For Val Florian, \$13.5. Consequently the Rikling premium-bribe would be \$6.3 million. For Florian, \$3 million. Total: \$9.3 million.

This rationale would eliminate any discussion of blockage, which warrants little consideration in any event. Blockage is ambivalent and could well cancel itself out. Every sale is a purchase and every purchase a sale, and each affects the market equally. Jarneen, therefore, simply needed time and deftness. The 9.3-million MRST shares outstanding, plus a two-million-share volume in the seven-month period ending March 26, 1973, should settle the matter.

THE ILLEGALITY OF THE PREMIUM

The determination of the free-market figure for Jarneen's

140. 187 F.2d at 51-52.

purchase should not unduly occupy a court, and from this point forward precedents governing premium-bribe illegality abound. True, even with a proven premium-bribe—its existence established and amount determined—the courts are still split about 50-50. But guidelines are emerging, and the answers have been attempted in considerable detail.¹⁴¹ Respectable authority—*Sugden, McClure, Bosworth v. Allen*,¹⁴² *Porter v. Healy*,¹⁴³ *Perlman v. Feldmann*,¹⁴⁴ *Caplan-Lionel*,¹⁴⁵ *Ferraioli v. Cantor*¹⁴⁶ and most recently the 1969 *Brown v. Halbert*¹⁴⁷ and *Jones v. Ahmanson*¹⁴⁸ have ordered over the premium-bribe to the corporation. At this late date the question should be closed: The 1968 *Porco*¹⁴⁹ and the 1969 *Painter*¹⁵⁰ were wrong. The “premium” for the sale of control is illegal, and belongs to the corporation.

THE DISPOSITION

But once awarded to the corporation, how would the \$9.3 million be distributed? May 19.3-percent stockholder Jarneen share in the “windfall?” Must Rikling and Florian disgorge the total \$9.3 million, or only the 87-percent public’s share? These extremely subtle questions have received almost total neglect at the hands of both court and commentator.¹⁵¹ In fact the Second Circuit, in *Perlman v. Feldmann*, is the only court to advert directly to the problem posed by the disposition of the premium-bribe. *Feldmann* righteously refused—albeit without support of precedent or reason—to let premium-briber Wilport, now with a third of Newport Steel, share in the \$2.1 million ostensibly destined for the corporate treasury, even though its *stock purchase* (without the premium) from *Feldmann* was perfectly legitimate. On the other hand the court, *mirabile dictu*, allowed *premium-bribed* *Feldmann* to keep a third of the premium-bribe he received for selling control of

141. Bayne, *The Sale-of-Control Premium: The Intrinsic Illegitimacy*, 47 *TEXAS L. REV.* 215 (1969).

142. 168 N.Y. 157, 61 N.E. 163 (1901).

143. 244 Pa. 427, 91 A. 428 (1914).

144. 219 F.2d 173 (2d Cir. 1955).

145. 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1964).

146. 281 F. Supp. 354 (S.D.N.Y. 1967).

147. 271 Cal. App. 2d 307, 76 Cal. Rptr. 781 (1969).

148. *Jones v. Ahmanson*, — Cal. App. 2d — (1969).

149. *Christophides v. Porco*, 289 F. Supp. 403 (S.D.N.Y. 1968).

150. 418 F.2d 545 (10th Cir. 1969).

151. Bayne, *supra* note 122.

Newport. To the contrary, the *Caplan-Lionel* court never mentioned the problem, and permitted Sonnabend's three percent to share in the \$135,000 he originally paid to premium-bribe Muscat.

The Rikling-Jarneen hypothetical is of course on all fours with *Feldmann* and *Caplan-Lionel*. The small share of Sonnabend may have escaped the court, but the Jarneen 13 percent—19.3 percent, with Val Florian's sale—would loom almost as large as the *Feldmann-Wilport* third. As between premium-bribed *Feldmann* and premium-briber *Wilport* why *Feldmann* favored *Feldmann* one will never know. The court's error is probably referable to its earlier error: No attempt was made to mulct civil damages from *Wilport* for its breach of trust in buying control of Newport Steel. Further, no criminal prosecutions were pressed against *Wilport* for commercial bribery.¹⁵² Civil damages and criminal fines, if not imprisonment—to say nothing of its "loss" of the \$2.1 million—would have completely cleansed *Wilport* of culpability. With its triple debt paid, no court would further bar *Wilport* personally from its just share in the corporation. As to the stock itself, it was hardly tainted, since the sale of a valuable commodity at an honest price was fully severable from the turpitude of the premium-bribe. Such reasoning should permit *Wilport*—and an analogous *Jarneen*—to enjoy the benefits of the entire award to the corporation. As for a *Rikling*, he too would be mulcted in civil damages, fined, even imprisoned, for commercial-bribe receiving,¹⁵³ and possibly for larceny by embezzlement.¹⁵⁴ Thus both would seemingly be equally purged. The upshot would find *Rikling* and *Florian* with their \$9.3 million disgorged, *Jarneen* without his original \$9.3 million but still holding the purchased 19.3 percent.

THE OFFICE OF CONTRÔLEUR

But what of control of Mythical *Rikling*? *Rikling*, guilty of premium-bribery and breach of trust, convicted of assorted crimes, would certainly never be restored to his original control position. Correspondingly, *Jarneen* equally proved his unsuitability by covering himself with the triple turpitude of premium-bribery. The civil damages, criminal fines, loss of the \$9.3

152. *E.g.*, in New York: See N.Y. Pen. Law § 180.00 (McKinney 1967).

153. See, *e.g.*, N.Y. Pen. Law § 180.05 (McKinney 1967).

154. See, *e.g.*, N.Y. Pen. Law §§ 60.10-2(d), 70.15-2 (McKinney 1967).

million, all are resultant on his active role in effecting the tripartite illegitimacy of the premium-bribe:

(1) the perversion of the judgment of the incumbent *contrôleur*, engendered by an appointment of a successor induced by a cause other than suitability, (2) that is, for consideration illicit in itself, (3) resulting in the appointment of a candidate unsuitable by reason of his own active role in the inducement.¹⁵⁵

Jarneen consciously set about (1) to pervert Rikling's judgment, (2) with illicit cash and (3) thereby foist a premium-briber on MRST. His removal is foregone and simple. With him, of course, would go his entire team, all those directors who executed the takeover.

The stock sales had the full approval of the companies in which Mr. Rikling and Mr. Weakly had their interests . . . and these companies welcome the chance of tying up with a major import/transport enterprise.¹⁵⁶

But the implementation of that removal carries the real problems: (1) How elect his successor? (2) And keep him elected? What of the 19.3-percent Jarneen block? The astute *Lionel* court in 1964 faced its Jarneen—and the identical problems—in the senior Sonnabend, now deceased. A. N. Sonnabend not only bought control of *Lionel* for \$135,000 but was prepared to sweeten the premium-bribe with \$75,000 in postresignation salaries and consultation fees for the selling *contrôleur* Muscat. More than that, Sonnabend was about to unleash several "dogs" on *Lionel*, notably *Mad*, from his Premier Corporation. With Sonnabend incumbent a new election would find the sheepish proxies putting Sonnabend right back into office. "Therefore, some restrictions of the present board are required, so that the Sonnabend group may not take advantage of the position they hold."¹⁵⁷ The New York court handled the matter in a most enlightened way (Subsurface of course was an unexpressed impugning of the outmoded "democratic" processes of the widely-held annual meeting):

They shall be restricted to current management problems and other matters necessary for the proper functioning of the corporation and they shall not be permitted to use their present offices as the means to secure stockholder approval for their designated directorial slate, or deal in matters involving self-interest, such as proposed acquisitions from Premier Corporation of America.¹⁵⁸

The 87-percent public minority shareholders of Mythical Rikling are in exactly the same fix as the 97 percent of *Lionel*.

155. Bayne, *supra* note 141, at 222.

156. *The Wall Street Review*, Mar. 27, 1968, at 4, col. 1.

157. *Matter of Lionel Corp.*, 151 N.Y.L.J. 14, col. 3, at col. 6 (1964).

158. *Id.*

It would appear the interests of all of the corporate body politic require that some method be evolved so that the holders of the other 97% of the corporate stock be given an opportunity to express and disseminate their views and suggestions and take whatever appropriate action they wish to with respect to both the future management of the corporation and the acquisition proposals which are about to be submitted to them. In other words, what is called for is some neutralizing element which will see to it that no undue advantage is arrogated to it by the current group and that other groups which may form will have an opportunity to take such action in the premises as they deem advisable.¹⁵⁹

The "neutralization" of the Sonnabend-Jarneen power "position" could be approached on two fronts: (1) The share dispersal, and (2) domination of the proxy-solicitation mechanism. The former seemed beyond change, so the *Lionel* court "neutralized" the latter.

In some jurisdictions the device of a Master in Chancery to supervise the election has been utilized for such purpose [citations]. In this and other States there have been instances of the appointment of a referee to perform like functions [citations]. Even within the confining limits of former section 25 of the General Corporation Law, a New York court recently designated such a supervisor under similar circumstances [citations].¹⁶⁰

Of course, the New York court was not truly circumscribed by "the confining limits of former section 25" and did not need to rely on the new section 619 which "empowers the court to 'take such other action as justice may require' in the premises."¹⁶¹ Since these are merely statutory enunciations of the broad equitable power possessed by every chancellor since the early 1300s, an equity court therefore could readily emulate New York:

The court, in order to take such action as "justice may require" must assure the use of the corporate proxy machinery for the best interests of all the stockholders of the corporation. To this end the court will designate a referee on the order to be entered herein. The said referee will perform such acts as may be necessary to effectuate the decision of the court.¹⁶²

With this the matter would seem to be closed. But what of the foreboding presence of the Jarneen 19.3-percent block brooding over new MRST *contrôleur*—assuming, of course, a *new* man—at every succeeding meeting over the coming years? Here an equity court could perhaps take a page from the Government's book in its unraveling of the knotty Du Pont-General

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

Motors antitrust problem.¹⁶³ A forced sale can be decently done. Du Pont was able to disburse 63-million shares of General Motors¹⁶⁴ without apparent damage. After all, two million shares of Mythical Rikling changed hands in a short seven months in 1972-73. Old man Weyenberg's successful secondary offer of Weyenberg Shoe unloaded in a day 222,725 shares at a not dishonest price on a free market. In November 1969, Cities Service announced the distribution to its own shareholders of 1.8- (of 2.3-) million shares of Atlantic Richfield "under a consent decree with the Justice Department."¹⁶⁵ Thus a negotiated plan of disbursal spread over five years and subject to the scrutiny of a court-appointed referee could adequately remove the Jarneen threat for the future, and do Jarneen no more harm than he deserves.

The Mythical Rikling hypothetical came along at a very appropriate day toward the elucidation of the most complex of the sale-of-control problems. No longer should "true investment value" successfully disguise a raw premium-bribe.

163. *United States v. E. I. Du Pont De Nemours & Co.*, 366 U.S. 316 (1961).

164. *Id.*

165. *The Wall Street Journal*, Nov. 4, 1969, at 12, col. 2. A corporation, such as Cities Service, has a ready recipient for any such distribution, and also a ready quid for the quo, Cities Service shares. In point of fact, European Import Companies holds the MRST shares, not Norton Jarneen personally. Which leads to the further thought of EIC-shareholder reaction to the loss of some \$10 million referable to the purchase of MRST control.