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1988]

THE S.E.C. AND THE SALE OF CONTROL:  
AMBIVALENCE, VACILLATION OR  
PUSILLANIMITY?

DAVID COWAN BAYNE, S.J.\*

Trafficking in control of investment  
trusts has reached surprising  
proportions.

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These are not the evils and abuses of the past.

— Robert E. Healy, Commissioner, Securities and  
Exchange Commission (1940).<sup>1</sup>

These many years later, a highlighted review of the seventies and eighties can readily testify to the same 'evils and abuses' in the sale of control. 'Trafficking in control' continues to be pervasive. The phenomenon, and its attendant legal complexities, surface in every area of modern corporate enterprise: banks, insurance companies, business corporations, investment companies, even taxation, whatever, wherever. And the samplings cover the nation.

In the closing hours of 1974, the five-year sale-of-control *Cincinnati Enquirer* litigation finally concluded.<sup>2</sup> A militant Enquirer minority had successfully aborted the sale of control of the Enquirer by the Scripps-Howard chain. The federal district court emphasized the contention "that the \$35 per share . . . constitutes a premium and that this alleged premium should be paid to the minority shareholders."<sup>3</sup> The averted premium over market totaled \$5 million. The allegations ranged from breach of fiduciary duty to conflict of interest and sale-of-control premium-bribery.<sup>4</sup>

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1. *Investment Trusts and Inv. Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 38 (1940) [hereinafter *Senate Hearings*].

2. *Ramey v. Cincinnati Enquirer, Inc.*, 508 F.2d 1188 (6th Cir. 1974), *cert. denied*, 422 U.S. 1048 (1975).

3. Brief for Appellant at 59, *Ramey v. Cincinnati Enquirer, Inc.*, 508 F.2d 1188 (6th Cir. 1974).

4. This is a gross simplification of a highly complex litigation, summarized

The post-trial Scripps-Howard capitulation rendered the matter moot. Counsel were awarded \$1 million.<sup>5</sup>

Even in the unsophisticated midwestern hinterland the barter of office is commonplace. In Iowa alone, three major sale-of-control cases, all three involving insurance companies, spanned the last decade. In *Rowen v. Le Mars Mutual Insurance Co.*,<sup>6</sup> irate policyholders successfully argued that insiders "offered to transfer for a substantial consideration the control of . . . Le Mars Mutual . . . through the sale of the offices of the directorships."<sup>7</sup> The premium-bribe was \$307,500. The total recovery—which included post-sale-of-control looting, a frequent consequent—was \$2.3 million.<sup>8</sup> *Le Mars* was a case of first impression in Iowa and established Iowa as the first state to pronounce unequivocally on the illegitimacy of the sale of control.

[W]e depend, as did the trial court, on the illegal sale of control to set aside the transaction. . . .

. . . .

All parties agree that directorships in a corporation are not for sale and that a contract for that purpose is illegal and unenforceable.<sup>9</sup>

*Le Mars* began in 1973 and concluded in 1985.

In the *General United Group*, litigation,<sup>10</sup> also in the Iowa state courts, the premium-bribe was \$1.4 million. The GUG policyholder contended that control of the company (1) was sold by a local Iowa group to the notorious Equity Corporation,<sup>11</sup> guided

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in the 6th Circuit opinion, 508 F.2d at 1190-94. The sale-of-control aspect of *Ramey* addressed the proposed sale of a sixty percent interest in the Cincinnati Enquirer by the Scripps-Howard group to the management of the Enquirer. 508 F.2d at 1190-91. See generally Record and Briefs, *Ramey* (Nos. 74-1110 to -1116).

5. The appeal in *Ramey* concerned a dispute among counsel over the fee. 508 F.2d at 1194-1200.

6. 282 N.W.2d 639 (Iowa 1979).

7. Petition in Equity, Div. I, para. 12, *Rowen v. Le Mars Mut. Ins. Co.*, No. 22725 (Iowa Dist. Ct., Plymouth County, May 7, 1973).

8. The lower-court award was over \$6 million, including \$2 million in punitive damages against the premium-briber, Iowa Mutual of De Witt. See *Rowen v. Le Mars Mut. Ins. Co.*, No. 22725, slip op. (Iowa Dist. Ct., Plymouth County, Oct. 3, 1977); *Rowen v. Le Mars Mut. Ins. Co.*, 282 N.W.2d 639, 661-63 (Iowa 1979). The Supreme Court of Iowa disallowed the imposition of punitive damages against Iowa Mutual, and otherwise reduced the award over three successive opinions: 282 N.W.2d 639 (Iowa 1979); 347 N.W.2d 630 (Iowa 1984); 357 N.W.2d 579 (Iowa 1984).

9. *Rowen*, 282 N.W.2d at 650, 659.

10. *Berger v. General United Group, Inc.*, 268 N.W.2d 630 (Iowa 1978).

11. *Id.* at 632. The Equity Corporation effected its first sale of control in

by the adept David Milton (undoubtedly the most long-lived and proficient of all premium-bribers, whose sale-of-control machinations covered nearly forty years<sup>12</sup>) and thence (2) passed legitimately to the Chicago-based All American group. The lawsuit was filed in early 1975 and thrown out in 1978 on jurisdictional grounds. The cause was merged out of existence by a cash-out merger.<sup>13</sup>

The third Iowa litigation was the most egregious. Policyholders claimed variously (1) waste of assets and (2) sale of control and embezzlement involving the Des Moines-based Statesman Group. The sale-of-control premium-bribery, \$6.8 million, and the embezzlement, another \$6.8 million, never reached the merits. A \$425,000 settlement was approved by the federal district court and affirmed by a unanimous Eighth Circuit,<sup>14</sup> in spite of the forceful briefs pleading for recognition of the sale-of-control premium-bribery and the embezzlement. That was June 1986.

The bank has always been a prime target for the sale of control, especially the savings and loan. A cursory reading of the 1973 case, *Beverly Hills Federal Savings & Loan Association v. Federal Home Loan Bank Board*,<sup>15</sup> might lead one to conclude that the federal court in California anathematized the sale of control and ordered the disgorgement of the \$1.5-million premium-bribe over to the bank. Certainly, the verbiage seems conclusive:

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1932 and its last as late as 1966. H.R. Doc. No. 279, 76th Cong., 1st Sess. 1039-43 (1940) [hereinafter REPORT]; Proxy Statement of General United Group, Inc. (July 10, 1967) [hereinafter Proxy Statement]. The Equity Corporation was "notorious" insofar as its avowed purpose was "the eventual acquisition by the legal processes of dissolution, merger, or consolidation of the assets of its subsidiaries and of other investment companies." REPORT, *supra*, at 1041.

12. David M. Milton (the divorced husband of Abby, sister to the five Rockefellers) was featured in the 1936-1940 SEC Study of investment companies—along with the slightly less notorious Floyd Odlum and Wallace Groves—for his calloused sales of control. REPORT, *supra* note 11, at 1039-41. For a discussion of the SEC study of investment companies, see *infra* note 31 and accompanying text.

Finally, some 34 years later, the SEC sought an injunction in federal court prohibiting David M. Milton from acting as an officer of any investment company. Mr. Milton consented in a stipulation to a permanent injunction. 33 SEC ANN. REP. 110 (1967); Securities & Exch. Comm'n v. Milton, Civ. No. 3053 (S.D.N.Y. 1966).

13. *Berger*, 268 N.W.2d at 638-39. A simultaneous federal action begun in 1975 and based on the same transaction continued through 1985. See *Shidler v. All Am. Life & Fin. Corp.*, 298 N.W.2d 318 (Iowa 1980); *Shidler v. All Am. Life & Fin. Corp.*, 775 F.2d 917 (8th Cir. 1985).

14. *Wiener v. Roth*, 791 F.2d 661 (8th Cir. 1986) (affirming lower court).

15. 371 F. Supp. 306 (C.D. Cal. 1973).

[T]he sale or transfer of control of a corporation at a premium and the transfer of corporate offices for a consideration without complete disclosure to minority shareholders has been widely held to constitute a breach of the majority's duty to the minority.<sup>16</sup>

But the opinion was muddled, and the case can stand for little more than another example of the prevalence of the sale of control. In 1974, a federal district court condoned the premium in *Harman v. Willbern*,<sup>17</sup> involving another savings and loan. So also in 1974 in *Thompson v. Hambrick*<sup>18</sup> in Texas. But in 1985 in the Missouri Court of Appeals a blatant sale of control of a small-town bank was struck down. The holding, however, was not founded on the usual strict-trust philosophy, but rather on 'partnership' fiduciary-duty principles mandating an equal offer<sup>19</sup> to all 'partners' in a close corporation. Missouri, nonetheless, could be classed with Iowa as reprobating the sale of control. This was *Forinash v. Daugherty*.<sup>20</sup>

The predictable spate of mutual-fund sale-of-control cases inspired by *Rosenfeld v. Black*<sup>21</sup> never materialized, but in *Rosenfeld* in contradistinction to *Statesman Group* of the Eighth Circuit<sup>22</sup>—the Second Circuit and Judge Friendly produced one of the leading control cases of the century.

We start from one of the "well-established principles of equity," recognized in *Insurance Securities* itself,<sup>23</sup> . . . "that a personal trustee, corporate officer or direc-

16. *Id.* at 314-15.

17. 374 F. Supp. 1149 (D. Kan. 1974), *aff'd*, 520 F.2d 1333 (10th Cir. 1975).

18. 508 S.W.2d 949 (Tex. Ct. App. 1974).

19. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965). Andrews presents a tenable theory for dealing with the sale of control in a stock corporation when the premium-bribe is camouflaged in a majority stock sale. The theory has no applicability when the premium-bribe passes in a nonstock company or in a stock company when unrelated to the stock, e.g., in collateral nonstock dealings between an incumbent contrôleur and the premium-bribing successor. The deficiency in Andrews theory lies in the absence of a philosophical base for outlawing the premium-bribe.

20. 697 S.W.2d 294 (Mo. Ct. App. 1985).

21. 445 F.2d 1337 (2d Cir. 1971).

22. *Wiener v. Roth*, 791 F.2d 661 (8th Cir. 1986).

23. *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 254 F.2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958).

*Insurance Securities* will figure prominently over the coming pages. It and *Rosenfeld v. Black* are central to any discussion of the SEC and the sale of control of mutual funds.

tor, or other person standing in a fiduciary relationship with another, may not sell or transfer such office for personal gain." There are ample authorities to support this proposition.<sup>24</sup>

In this limited sale-of-control area of 'trafficking in control of investment trusts' the paradigmatic *Rosenfeld* will help form the future.

The 1974 Tax Court case, *Estate of William du Pont, Jr.*,<sup>25</sup> offers a fascinating, although obiter, commentary on the philosophy of the sale of control. For years, the Internal Revenue Service has countenanced a premium in the sale of control:

[C]ontrol of a corporation . . . , representing as it does an added element of value, may justify a higher value for a specific block of stock.<sup>26</sup>

Since respective counsel regrettably never argued to the core issue in *Du Pont*, some important insights into the sale-of-control rationale were never forthcoming.<sup>27</sup>

#### Whither the SEC?

Aloof and seemingly disdainful of this disturbing control melange,<sup>28</sup> stands impassively the chief federal guardian of corporate morality, derelict in one major area where its leadership could set the example. As the bellwether, the SEC could lead the way for all. The Congress has charged the Commission with a general mandate "to provide protection for investors."<sup>29</sup> Specifically, and relevantly, the Commission has direct custody over investment companies and consequently, must scrutinize closely any 'traffic in their control.' The impact of forceful and uncom-

24. *Rosenfeld*, 445 F.2d at 1342 (quoting *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 254 F.2d 642, 650 (9th Cir. 1958)).

25. *Estate of William du Pont, Jr. v. Commissioner*, 63 T.C. 746 (1975).

26. Rev. Rul. 59-60, 1959-1 C.B. 237, § 4.02(g).

27. A study of the briefs at the Tax Court level indicates that the principal emphasis has been on expert testimony with no argument on the intrinsic right or wrong of a premium for control. Yet, if such a premium is turpitudinous, no added value could be assessed on a control block and hence no added tax.

28. Lest one might think the sale-of-control premium-bribe is evanescent, note that the Sulzbergers do not think so: "Under the new provisions [among the controlling family members], the Class B shares will be priced at the market value of the class A shares. This eliminates the possibility that a family member could gain any of the premium that is customarily payable for control shares." Lewin, *Times and Sulzbergers Take Steps to Keep Company Under Family*, N.Y. Times, June 20, 1986, at 1, col. 2 (midwest ed.).

29. SECURITIES & EXCH. COMM'N, *THE WORK OF THE SEC* 3 (1986).

promising SEC leadership in this narrow but important field of the mutual fund would be incalculable. Such Commission leadership would undoubtedly span out beyond the sale-of-control fundamentals applied to the mutual-fund industry and be an exemplary force across the board: for banks, business corporations, insurance companies, tax claims, whatever, wherever.

This, then, is an 'open letter' to the Commission. The hope is a reassumption of the role it abandoned some 25 years ago and an embrace once again of the pristine dogma so staunchly supported for three decades. In 1956, the Commission's credo was categorical. Witness the Commission's brief in the crucial *SEC v. Insurance Securities, Inc.*:

We believe that . . . there can be no dispute about the fundamental propositions that a fiduciary cannot exploit his position of trust for his own benefit by selling his office directly, through the sale of stock control, or in any other manner. This is well-established in equity *with respect to trustees, receivers, administrators, guardians, and corporate directors or officers*. It has been set forth time and again . . . [by] courts of equity, and has received the full endorsement of authoritative commentators. . . . [T]he fiduciary . . . may [not] auction off his position on the eve of retirement as an additional reward for work well done.<sup>30</sup>

Clearly the Commission had no thought that this 'fundamental proposition' so 'well established in equity' was limited solely to mutual funds. Rather, the reach of the proposition rightly embraces "trustees, receivers, administrators, guardians, and corporate directors or officers." This conviction of the Commission should shape the coming decades. No official spokesman bears a bigger burden for the legal and ethical well-being of our corporate system.

#### *The Thesis of the Open Letter*

*The Securities and Exchange Commission (1) in its earliest years opposed uncompromisingly the premium-bribery in the sale of control, (2) diligently elaborated a tenable philosophy supporting this opposition, and (3) then, in the face of adversity, inexplicably fled*

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30. Brief for the Securities & Exch. Comm'n, at 55-56, *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 254 F.2d 642 (9th Cir.), cert. denied, 358 U.S. 823 (1958) (emphasis added) [hereinafter Brief].

*the field. The Commission has been either genuinely perplexed, unfortunately wavering or regrettably timid. The last seems closest to the mark.*

The development of the Commission's control philosophy occupied twenty years beginning in 1936, just two years after the Commission's creation, and reached full flower toward the end of 1956. During these decades, the Commission studiously spelled out its fundamentals of corporate control and defended them *mordicus* whenever necessary. Throughout, the Commission's stance was unwaveringly uniform. The years 1936-1956, therefore, are pivotal and supply the content to the SEC philosophy that will establish the thesis set for proof.

These years and this philosophy—this open letter—will be approached in three parts: I AN HISTORICAL CONSPECTUS; II THE SEC PHILOSOPHY OF CORPORATE CONTROL; III CONCLUSION: THE COMMISSION FLEES THE FIELD.

### I. AN HISTORICAL CONSPECTUS

From the standpoint of the SEC philosophy of corporate control, the years from 1936 to 1956 presented an integrated picture of unvarying consistency and doctrinal unity. An historical chronology of this period, therefore, does not deserve particular emphasis. True, milestones do mark the way, but the unbroken conformity among the official studies, reports and releases obviates the necessity of special commentary from the historical aspect. Some sense of chronology of the major Commission sale-of-control pronouncements, however, should be helpful in understanding the overall formulation of the Commission's position.

This historical conspectus is punctuated by five documents, and these documents are the milestones along the road to the development of the Commission's philosophy: (1) *The 1936-1940 SEC Study*;<sup>31</sup> (2) *The 1942 Opinion of the Commission's General Counsel*; (3) *The Incorporated Investors Case*; (4) *The 1955 SEC Annual Report*; and (5) *The Insurance Securities Litigation*.

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31. This catch-all description has been used to include the broad SEC activity, 1936 to 1940, not only the work of the Study of investment trusts and investment companies and the direct product of the Study, the 1938-1940 SEC Report, but also, somewhat loosely, the Senate Hearings of 1940, conducted toward the Investment Company Act of 1940. The 1938-1940 SEC Report was published in seven volumes and six supplements. *See infra* note 33. The Senate Hearings are contained in four volumes. *See supra* note 1. The nature and content of these volumes will be specified apropos.



1. *The 1936-1940 SEC Study*

In 1935, when the Commission was only one year old and Joseph P. Kennedy was still Chairman, the Congress, in passing the Public Utility Holding Company Act, (as the Senate hearings made clear) "not only authorized, but directed, the Securities and Exchange Commission to make a study of investment trusts and investment companies, and to report its findings and recommendations to the Congress."<sup>32</sup> This four-year Study—from 1936 to 1940—under the general supervision of Commissioner Robert E. Healy, supplied the bulk of the raw material for the corpus of the Commission's philosophy. The resultant, voluminous 1938-1940 SEC Report<sup>33</sup>—and the concomitant Senate hearings<sup>34</sup> held pursuant to the drafting of the Investment Company Act of 1940—contained, even at that early date, all the seminal principles for the formal construction of the SEC primer on corporate control. Of course the 1936-1940 Study—as well as the 1938-1940 SEC

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32. *Senate Hearings*, *supra* note 1, at 33.

33. The overall Report of the SEC, entitled *Investment Trusts and Investment Companies*, consists of five parts: (1) Part I was sent to the Congress on June 10, 1938 and is entitled "The Nature, Classification, and Origin of Investment Companies," H.R. Doc. No. 707, 75th Cong., 3d Sess. (1938); (2) Part II, "Statistical Analysis of Investment Trusts and Investment Companies" (submitted to the Congress on March 10, 1939), H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939); (3) Part III, "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies" (which discusses the evils and malpractices of the investment trusts and companies, and was submitted to the Congress in separate sections on August 7, 1939 and February 8, 1940), H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939), and H.R. Doc. No. 136, 77th Cong., 1st Sess. (1940); (4) Part IV, "Economic Significance in Control of Industry" and (5) Part V, "Conclusions and Recommendations" (submitted June 9, 1941), H.R. Doc. No. 246, 77th Cong., 1st Sess. (1941). In addition, six supplemental reports were submitted to the Congress in 1939-1940. See H.R. Doc. No. 246, 77th Cong., 1st Sess. (1941) (complete listing of all Reports submitted in connection with the Study). Part III, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1940) [cited throughout as REPORT], provides the materials for this "open letter" to the Commission.

In addition to the general preparatory work of the Study, the SEC itself conducted public examinations of 250 companies. In these public hearings by the Commission, the companies examined were represented by counsel and were entitled to cross-examine witnesses produced by the Commission and to present evidence through witnesses of their own choosing. The record of these public examinations consisted of 33,000 pages of transcript and 4,800 exhibits. The record was not printed by Congress and therefore is only available in type-written form from the Commission in Washington, D.C. *Senate Hearings*, *supra* note 1, at 40-41.

34. A Subcommittee on Securities and Exchange of the Committee on Banking and Currency, under the chairmanship of Senator Robert F. Wagner of New York, conducted hearings over a 20-day period in April and for two days in late May and June, 1940. These hearings resulted in the Investment Company Act of 1940. *Senate Hearings*, *supra* note 1.

Report and the Senate hearings—covered the entire mutual-fund field, but the ‘evils and abuses’ in ‘trafficking in control’ figure prominently and consistently throughout the years of study and the weeks of testimony.

David Schenker was the chief counsel and operating director of the Study. His trenchant insights are evident throughout these formative years. This 1936-1940 SEC Study—as broadly described to include the Study itself as well as the SEC Report of 1938-1940 and the Senate hearings—necessarily ranks as the basic influence on, and a major statement of, the Commission’s sale-of-control philosophy. In substantive content it is almost on a par with the key *Insurance Securities* material.<sup>35</sup>

### 2. *The 1942 Opinion of the Commission’s General Counsel*

Since the ‘evils and abuses’ of the twenties and thirties continued on into the forties, even after the passage of the 1940 Act, the Commission on May 11, 1942—in an SEC Release under the Investment Company Act—“made public an opinion of its General Counsel, Chester T. Lane.”<sup>36</sup> This opinion was the first formal statement of the Commission’s policy developed over the four years of the 1936-1940 SEC Study. The brevity of the opinion—it was only two pages—and the uncompromising firmness of the declaration jointly contributed to its impact on the financial and business community. Its lack, however, of discursive philosophical commentary renders it less important as a doctrinal source.

### 3. *The Incorporated Investors Case*

The continuity of the SEC position during the 1936-1956 decades was preserved by an inconspicuous SEC Release in 1954 under the Investment Company Act, *In re Incorporated Investors*.<sup>37</sup> *Incorporated Investors* was notable for what it left unsaid, for its unspoken assumptions and the routine manner of its issuance. The matter involved a *legitimate* ‘transfer of control’ (in contradistinction to an *illegitimate* ‘sale of control’ involving a premium-bribe) and was later adduced by the Commission as a prototypal exam-

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35. Brief, *supra* note 30.

36. Opinion of General Counsel of Commission, Securities & Exch. Comm’n, Investment Company Act Release No. 40-354, [1941-1944 Dec.] Fed. Sec. L. Rep. (CCH) ¶ 75,281 (May 11, 1942).

37. Securities & Exch. Comm’n, Investment Company Act Release No. 1947 [1952-56 Dec.] Fed. Sec. L. Rep. (CCH) ¶ 82,058 (Feb. 3, 1954).

ple of what the Commission expected at the time of the transfer of an investment-advisory contract.<sup>38</sup> The Commission regarded *Incorporated Investors* as an “illuminating illustration of the principle” long reflected in “the historic trust obligations prescribed by courts of equity.”<sup>39</sup> As with the 1942 SEC Release containing the opinion of the Commission’s general counsel, *Incorporated Investors* was more exemplary than substantive.

#### 4. *The 1955 SEC Annual Report*

The Commission’s 21st Annual Report of its activities for its fiscal 1955 year was noteworthy for two relatively minor reasons. First, it reinvigorated the 1942 Opinion of General Counsel Lane with the firm announcement that “the purported transfer of an investment advisory contract for a consideration would constitute a gross abuse of trust and be the subject of Commission action.”<sup>40</sup> Second, the Annual Report made it clear that the premium-bribery and trafficking in control of earlier decades was still rampant in 1955: “Such questions arose with increasing frequency during the fiscal year.”<sup>41</sup>

#### 5. *The Insurance Securities Litigation*

In 1956, the contrôleurs of Insurance Securities, Incorporated, a mutual fund, allegedly sold their control for a \$4.37-million premium-bribe. This flagrant violation of the twenty year-old SEC proscription against the barter of office necessarily goaded the Commission into legal action and consequently, a conscious formulation of the philosophy that lay scattered through the many volumes of the 1940 SEC Report on Investment Trusts and Investment Companies. Defeat on the federal district level<sup>42</sup> forced the Commission at last to excogitate an integrated philosophical system in preparing the appeal. The result was an invaluable SEC corpus juris of corporate control. The Commission’s detailed and clearly enunciated position throughout the *Insurance Securities* litigation will form the philosophical framework for yet further refinement drawn from other SEC pronouncements, principally the 1938-1940 SEC Report. The collec-

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38. Brief, *supra* note 30, at 78-79.

39. *Id.*

40. 21 SEC ANN. REP. 100 (1955).

41. *Id.*

42. *Securities & Exch. Comm’n v. Insurance Sec., Inc.*, 146 F. Supp. 778 (N.D. Cal. 1956), *aff’d*, 254 F.2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958).

tive Commission effort of *Insurance Securities*, however, undoubtedly constitutes the preeminent treatise on the SEC philosophy of corporate control. This treatise then will accordingly constitute the heart of this study, but abetted of course by the other supporting SEC materials.

Henceforward only obiter adersion will be made to this historical chronology. With this chart in the background, the emphasis will be on the substantive philosophy, regardless of particular dates and periods within the two decades of 1936-1956. Since these 20 years are a philosophical unit, individual historical hills and valleys are not too important.

## II. THE SEC PHILOSOPHY OF CORPORATE CONTROL

During the 20 years of 1936-1956, the Commission methodically added bit by bit to the somewhat amorphous mass of facts, memoranda and releases which *in globo* constituted a complete, albeit unorganized, philosophy of corporate control. The Commission's philosophical position was unmistakable, but the various principles, subprinciples and seemingly disparate corollaries of this position had not yet been synthesized into a coherent corpus.

This synthesis and the final elaboration of a coherent corpus of the Commission's philosophy was achieved in four steps: (1) *The Landmark Insurance Securities Litigation*; (2) *The SEC Brief: The Authoritative Voice of the Commission*; (3) *The Commission's Official Position*; and (4) *The Corpus of the Commission Philosophy*.

### 1. *The Landmark Insurance Securities Litigation*

From its inception in 1938, Insurance Securities, Inc.—an independent Delaware corporation based in Oakland, California—was the typical jack-of-all-trades so characteristic of the mutual-fund service company. ISI was especially designed by its promoters to (1) create and sponsor its very own mutual fund, (2) manage the fund's day-to-day operations, (3) select the fund's portfolio of securities, (4) provide continuing investment advice, and to cap it off (5) fill the role of principal underwriter.<sup>43</sup> In short, ISI was to perform every conceivable function a mutual-fund service company—or even a mutual fund itself, for that matter—could possibly perform. And it was very closely held. By

43. Record at 4-6, *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 254 F.2d 642 (9th Cir. 1958) [hereinafter Record].

1956, the year of the SEC litigation, ISI had a total of nine shareholders. No more. Four of these, individual defendants, Leach, Carr, Lonergan and Haight, were directors and officers and held 72.6 percent of the outstanding shares.<sup>44</sup> The balance, 27.4 percent, was held by the other five. The Leach Group was the untrammelled *contrôleur* of ISI.

### *The "Trust Fund"*

But obviously the Leach Group had thoughts far broader than an isolated service company. And these thoughts coalesced in the "Trust Fund." The Trust fund was created contemporaneously with ISI, and 'creature' indeed it was. In truth, the Trust Fund was wraithlike. It had virtually no body, no discernible life of its own, and was wholly dependent on ISI for every vital function.

The Trust Fund was not a corporation, but was organized under California law pursuant to a Trust Agreement. Necessarily it had no shareholders, merely public investors who contributed their funds and received Participation Agreements. Thanks to continuous Participation offerings, the investing public swelled the net assets of the Trust Fund to \$215 million by 1955.<sup>45</sup> The \$215 million of public investment was in turn invested in stocks of various insurance companies. Hence, *Insurance Securities, Inc.*

Moreover, the Leach Group had been thorough. Their control of this \$215 million was absolutely unfettered. The public investors had no general voting rights. The Trust Fund—unlike most mutual funds—had no officers of its own, no board of directors, no voice at all beyond the annual and perfunctory necessity of approving the all-embracing service contract with ISI. (In fact, ISI itself had only about \$1 million in total assets and its Shareholders Equity was only \$300,488.<sup>46</sup>) The Trust Agreement, pursuant to section 15 of the Investment Company Act,<sup>47</sup> provided further that an assignment by ISI of the service contract triggered automatic termination, and necessitated investor-approved reinstatement.<sup>48</sup>

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44. *Id.* at 7-8.

45. *Id.* at 5-6.

46. *Id.* at 7, 16-17.

47. 15 U.S.C. § 80a-15 (1982) (enacted in 1940).

48. Record, *supra* note 43, at 6, 7.

## A Point for Emphasis

The interjection of a separate corporate entity, ISI, between the *contrôleur* of ISI, the Leach Group and the public investors' \$215 million in the Trust Fund could be a red herring, and perhaps divert attention from a salient fact in this entire study: The four human beings of the Leach Group had unhampered control over the public \$215 million, regardless of the legal fictions separating them. This was the 'control' about to be sold. How may it thus be said so firmly that the four had—and hence were able to sell—control of these public dollars? The answer: (1) The Leach Group owned a majority of ISI stock. The public owned none. (2) ISI, *aliis verbis* the Leach Group, had the unchallenged control of the proxy mechanism of the Trust Fund. (3) The invariable sheepishness of the public Participation shares guaranteed a near-unanimous vote of approval of any matter submitted in a Trust Fund proxy. No public investor ever voted against the Leach Group.<sup>49</sup> (4) Transfer of control over the proxy, therefore, was transfer of control of the Trust Fund. Infallible. No third party could or did dictate to the Leach Group. Thus, when these four men accepted a \$4.37-million premium to hand over control of the proxy, that premium carried control over \$215 million in public money. This is what it means to say that the Leach Group was the untrammled *contrôleur* of the Trust Fund, and the public \$215 million. To speak, therefore, of the sale of control of ISI is to speak of the sale of control of the Trust Fund, and the investors' dollars.

This disturbing fact of mutual-fund life was in the forefront of Commission thinking when it began its attack on the 'evils and abuses' of 'trafficking in control.' The reams of 1936-1940 testimony taught the Commission these elemental lessons:

In the absence of a substantial stock interest . . . , managers of investment companies held control either because of the inertia of stockholders combined with . . . control of the proxy machinery or by means of long-term management contracts. To acquire control in these situations, the acquiring company purchased the management contracts at attractive prices. These management contracts usually had been taken by the sponsors of in-

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49. Thus the Brief: "[C]ontrol of the proxy machinery, combined with the natural prestige of management and aided by the apathy of investors, effectively assured the election of the sponsor's nominees." Brief, *supra* note 30, at 32.

vestment companies prior to the public sale of the company's securities. They were solely the result of self-dealing upon the part of the sponsors.<sup>50</sup>

The "control," whatever its source, had the pecuniary characteristic of salability at attractive prices.<sup>51</sup>

Just as the Trust Fund did nothing for itself, so ISI on its part did nothing<sup>52</sup> except its fivefold business with the Trust Fund. Expectably, the coffers of ISI (that is, the nine sole owners of ISI) were rewarded handsomely for this stewardship of the Trust Fund. As a starter, ISI began with a 'Creation Fee,' or sales load, for each sale of a Participation Agreement to the public investor. Then ISI added an annual 'Management Fee' for running the day-to-day operations. And finally, an 'Advisory Fee' for supervising the portfolio. For the three-year period ending with the SEC action, ISI exacted over \$10 million in fees from the Trust Fund.<sup>53</sup>

*"The Sale of Control of ISI"*<sup>54</sup>

This was the scene in early 1956 when the Leach Group "embarked upon a plan to sell their controlling stock interest to a small group of purchasers. The sales were arranged through Kaiser & Co., an investment banker in San Francisco, California."<sup>55</sup>

The price paid for the stock was \$50 per share, although the net asset value of the ISI stock as of June 30, 1956, was only \$1.81 per share. [Citation.] For its services, Kaiser & Co. received a beneficial interest in the stock.<sup>56</sup>

Thus the four sellers received a \$4.37-million premium for the sale of the control block of stock. The four members of the Leach Group itself sold only 40% of the ISI shares—out of a total 72.6%—in several successive transactions (which the court treated as a moral unit) and the balance was acquired by the Kaiser Group from four of the five other ISI stockholders.<sup>57</sup> Under the Act, this sale constituted a transfer of control from the Leach

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50. REPORT, *supra* note 11, at 1089.

51. *Id.* at 1066.

52. Record, *supra* note 43, at 5.

53. *Id.* at 6.

54. Brief, *supra* note 30, at 6.

55. *Id.*

56. *Id.* at 7.

57. Record, *supra* note 43, at 9, 58.

Group to Leland M. Kaiser and his cohorts.<sup>58</sup>

*The Proxy Solicitation*

Inspired by the mandate of the Act,<sup>59</sup> “ISI commenced the solicitation of proxies for a meeting of investors . . . to vote on . . . the reinstatement of the investment advisory and principal underwriting contracts between ISI and the Trust Fund.”<sup>60</sup> Investors, of course, were urged to act favorably on these and other proposals.<sup>61</sup> Stress again that this vote was strictly perfunctory, and that the assured investor approval was the key to the Leach Group’s ability to sell control to the Kaiser Group.

Conveniently and predictably,

[t]he proxy material did not disclose the details of the transactions that led to the change in control of ISI. Nor were investors told of the net asset value of the ISI stock and the price the director-defendants were paid for their stock.<sup>62</sup>

Repeat also the obvious that to speak of the sale of control of ISI is to speak of the sale of control of the Trust Fund.

*The SEC Suit*

On August 13, 1956, the Commission instituted an action against ISI, the Leach Group and Leland M. Kaiser, alleging

that the payment for stock control at \$50 per share, as against net asset value of \$1.81 per share, represented no payment for any asset or assets owned by ISI; that the purchase price reflected the value of the . . . substantial fees from the Trust Fund under the investment advisory and principal underwriting contracts . . . and . . . being an asset of the Trust Fund, equitably belongs to the Trust Fund.<sup>63</sup>

“For appropriating such pecuniary advantages to their own account and benefit and for profiting from their fiduciary relation-

58. Under Section 2(a)(9) of the Act, 25 percent or more of the voting stock of a company constitutes presumptive control. 15 U.S.C. § 80a-2(a)(9) (1982).

59. Investment Company Act, 15 U.S.C. §§ 80a-15(a) and -15(b) (1982).

60. Brief, *supra* note 30, at 11.

61. Record, *supra* note 43, at 21.

62. Brief, *supra* note 30, at 11.

63. *Id.* at 12.



ship to the Trust Fund,"<sup>64</sup> the Commission sought: (1) The disgorgement by the Leach Group of the \$4.37 million premium-bribe over to the Trust Fund and (2) the Permanent removal of the Kaiser Group from control of both ISI and the Trust Fund.<sup>65</sup>

On November 29, 1956, the federal district court in California granted the defendants' motion to dismiss for failure to state a cause of action.<sup>66</sup> The Kaiser Group, now in control, had agreed not to vote the proxies until after judicial determination of the basic issues. Since the SEC lost on both district and circuit levels, the election later went forward. Even in the face of the SEC lawsuit the sheepish investors confirmed the invulnerability of the Kaiser Group control—with its domination of the proxy mechanism—by approving the new contract. Thus was the sale of control from Leach to Kaiser consummated.

## 2. *The SEC Brief: The Authoritative Voice of the Commission*

The brief of the Commission filed with the Ninth Circuit in July 1957 ran some 112 pages and constituted the very synthesis of the Commission's control philosophy that had been lacking for some twenty years. Here was a thorough, exact and formal statement, cohesive and technical, of the Commission's thinking on the sale of control.

Granted, one could persuasively argue that the Commission's position had long been adequately expressed in (1) the many volumes of the 1940 SEC Report, (2) the 1942 Opinion of the Commission's General Counsel, (3) the *Incorporated Investors Case* and (4) the 1955 SEC Annual Report. But this unconnected congeries of statements lacked the cohesive, and to an appreciable extent the authoritative, force of the Circuit Brief. Thus, perhaps as important as the quality and completeness of the Brief was the indisputable authority with which it spoke.

During the chairmanship of Ralph H. Demmler (1953-1955), the Commission instituted a practice that was to guarantee to the SEC Brief the authenticity of an official SEC imprimatur. Chairman Demmler had insisted that the five-man Commission itself first review and then personally clear all briefs before they were filed. The avowed purpose of the Demmler approach stemmed

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64. *Id.*

65. *Id.* at 13.

66. *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 146 F. Supp. 778, 781 (N.D. Cal. 1956), *aff'd*, 254 F.2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958).

from a conviction that the Commission's philosophy of the law must exert a maximum impact on the financial and legal community. This Demmler policy consequently included a painstaking study by the Commissioners themselves of the content and expression of the all-important legal philosophy that necessarily permeated and guided the Commission's briefs. Interestingly, moreover, these were by no means New Deal days. Chairman Demmler and the Commission were almost militantly determined to impregnate the thinking of the day with the traditional, conservative, Republican view of the law.

Among the five Commissioners during the Demmler chairmanship was J. Sinclair Armstrong, Esq., who assumed the Chairmanship on May 25, 1955, and was incumbent from the beginning to the end of *Insurance Securities* and the ISI Brief. Hence the methodical procedures of review and clearance—and the philosophical scrutiny—of the Demmler period continued unchanged throughout the tenure of Chairman Armstrong.<sup>67</sup>

Moreover, the days of *Insurance Securities* and the ISI Brief fell during the incumbency of the forceful Thomas G. Meeker, Esq. as General Counsel. Mr. Meeker, as chief counsel on the Brief, was scrupulous in getting full Commission approval of his work. (Aaron Levy, Esq. did the yeoman work under the day-to-day supervision of General Counsel Meeker.) Because of the implementation of this Commission policy by both Messrs. Armstrong and Meeker, the ISI Brief was more truly the official work of the Commission than, for example, it would have been under Chester Lane or Louis Loss.

Furthermore, the *Insurance Securities* litigation occasioned such unusual concern in the mutual-fund industry that it received even more meticulous scrutiny by the Commission than other briefs of the period. Frequent memoranda circulated through the Commission. Hours and hours of debate honed the issues and refined the final product. Nor did the industry lack vocal representatives. Alfred Jaretzki, Jr., among many, vigorously argued the position of the Investment Company Institute (Jaretzki of Sullivan & Cromwell was lead counsel for the ISI defendants and later the partisan author of several journal articles on the subject).<sup>68</sup> Over this period, nothing received more serious attention

67. The ISI Circuit Brief was dated July, 1957. Mr. Armstrong relinquished the chairmanship on May 27, 1957. 23 SEC ANN. REP. xii (1957). Therefore, even were the Demmler-Armstrong policy to have ceased abruptly with the resignation, the Brief nonetheless would have felt its full impact.

68. Jaretzki, *Duties and Responsibilities of Directors of Mutual Funds*, 29 LAW &

than *Insurance Securities* and the ISI Brief.

Remarkably (at the insistence of Leland M. Kaiser himself, the ISI investment banker, leader of the Kaiser Group, *contrôleur* of both ISI and the Trust Fund and a principal defendant, whose political influence was not inconsiderable) both Senator Fulbright and Senator Dirksen actively intervened to insure a forceful presentation of the mutual-fund-industry position. In a word, by the time the Commission's control philosophy was reduced to formal presentation in the ISI Brief, it had been debated, reviewed and refined with precision. No doubt could remain, therefore, that this ISI Brief was the authentic and authoritative pronouncement of the Securities and Exchange Commission on its philosophy of the sale of corporate control.

### 3. *The Commission's Official Position*

Early in the Brief, the Commission presented a succinct statement of the underlying rationale of this sale-of-control philosophy. The twenty years of 'evils and abuses' of 'trafficking in control' had conditioned the Commission for uncompromising forthrightness:

We believe that . . . there can be no dispute about the fundamental proposition that a fiduciary cannot exploit his position of trust for his own benefit by selling his office directly, through the sale of stock control, or in any other manner.<sup>69</sup>

The elaboration of this basic SEC thesis was the principal burden of the ISI Brief.

#### *The SEC and Equity*

Since the Commission had been expressly entrusted with the enforcement of the Investment Company Act, the ISI litigation was necessarily approached at the outset under the aegis of the Act. The attack relied on two principal sections:

Section 15(a) requires that the investment advisory contract must be approved initially by a vote of the investors or their board of directors. A vote is also required for the annual renewal of the contract. The

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CONTEMP. PROBS. 777 (1964); Jaretzki, *The Investment Company Act: Problems Relating to Investment Advisory Contracts*, 45 VA. L. REV. 1023 (1959).

69. Brief, *supra* note 30, at 55-56.

contract is non-assignable and is automatically terminated upon assignment by the investment adviser. . . . Section 36 provides for the judicial removal of an investment adviser or principal underwriter where, in an action by the Commission, it is determined that such investment adviser or principal underwriter is guilty of "gross misconduct or gross abuse of trust" in respect of the registered investment company.<sup>70</sup>

However, the Commission made it emphatically clear that it would be improper to construe "the voting requirements under Section 15 as a substitute for the fiduciary standards *incorporated* in Section 36."<sup>71</sup> Obviously, for present purposes this emphasis by the Commission is most important. The Commission bottomed its argument on the strict-trust philosophy of traditional equity. The Commission was unequivocal: "Section 36 derives its meaning from historic equitable principles which are incorporated therein and from the statutory purposes and policies of the Act."<sup>72</sup>

The sense of philosophical cohesiveness and continuity over the twenty-year span, 1936-1956, prompted the Commission, whenever appropriate, to buttress the argumentation of the ISI Brief with relevant historical support, from pronouncements of both Commission and courts. Thus, in seeking confirmation of its interpretation of the equitable approaches of Section 36, the Commission advertently viewed Section 36 "in the light of the Opinion of the Commission's General Counsel made public on May 11, 1942, which sets forth as Commission policy the construction of Section 36 now urged by the Commission in this case."<sup>73</sup>

Even further, the Commission saw strict trust and equity at the foundation of the legislative intent permeating the Act:

Since the Congress could not in detail proscribe every means or device by which a faithless fiduciary might exploit his position of trust for his own account and benefit, the broad and inclusive provisions of Section 36 and the *equitable principles embodied therein* are of central impor-

70. *Id.* at 3.

71. *Id.* at 16 (emphasis added).

72. *Id.* at 17.

73. *Id.* at 8.

tance in the enforcement of fiduciary standards.<sup>74</sup>

Time and again throughout the Brief (and for that matter throughout all the documents of 1936-1956) the Commission reiterated its reliance on principles far more fundamental than the literal language of Section 15 and Section 36: "We submit that all of these [equitable] doctrines were incorporated by the Congress into Section 36 and should be enforced by a court when its equitable jurisdiction is invoked thereunder."<sup>75</sup> And again:

Accordingly, in construing Section 36, the court, as a court of equity, should apply the historic equitable principles to their fullest extent, and thus give due and proper effect to the statutory measures and policies which Section 36 was designed to implement.<sup>76</sup>

Probably the most ringing statement of the Commission's reliance on strict trust and equity came midway in the Brief:

There is no need to emphasize that the conceptions of fiduciary duty and remedy exemplified in these cases were not created by statute. They were developed by courts of equity as instruments of public policy in order to prevent corrosion of the fiduciary responsibilities of those who have undertaken to manage money or property of others or to act on their behalf.<sup>77</sup>

Not only is the ISI Brief the authoritative voice of the Commission, but it is a formal statement of a broad philosophy of strict trust and equity, and is by no means a narrow application of two specific sections of the Act. In truth, the Brief is traditional equity, pure and simple, applied to the sale of control of a mutual fund.

#### *The Intent of Congress*

Perhaps more to the point, it would be myopic to ascribe the philosophy of *Insurance Securities* and the ISI Brief exclusively to the SEC. The Commission, after all, was conscientiously attempting to implement the will of the Congress, so clearly expressed in the legislative history of the 1940 Act. Thus the Brief:

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74. *Id.* at 18 (emphasis added).

75. *Id.* at 20.

76. *Id.* at 28.

77. *Id.* at 66.

The purpose of Section 36 . . . is to enforce fiduciary standards with respect to the management of investment companies . . . . This is one of the main themes of the Act, since, as the Congress found, investment companies, by reason of their liquidity and the marketability of their portfolio securities, had been particularly susceptible of abuse. One of the major abuses stemmed from the management contract, which was not only a lucrative source of income but also an instrument of control and, as such, was the subject of indiscriminate trading by and for the benefit of management.<sup>78</sup>

This open letter directed to the Commission, therefore, could appropriately command congressional attention as well, since the Congress, too, has been neglectful of its avowed determination to eradicate “[o]ne of the major abuses stemm[ing] from the management contract which was . . . an instrument of control and . . . the subject of indiscriminate trading.”<sup>79</sup> The Commission identified its objectives and philosophy with the objectives and philosophy of the Congress:

The Commission’s interpretation of Sections 15 and 36 aids in the achievement of the legislative policy to eliminate trading in investment advisory and principal underwriting contracts. . . . Succession to these contracts may once more be put on the auction block for sale to the highest bidder for the benefit of management, and the purchasers may be tempted to pursue hazardous or doubtful policies in order to recoup as quickly as possible the substantial price they paid for stock control and the succession of the agreements.<sup>80</sup>

The Commission was convinced that the copious findings of fact of 1936-1940 presented in the 1940 SEC Report became an integral part of the legislative history of the 1940 Act.

As indicated in the legislative history, the Act is “the outgrowth of a comprehensive study and investigation of investment trusts and investment companies by the Securities and Exchange Commission pursuant to the direction of the Congress.” The Commission’s reports

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78. *Id.* at 17.

79. *Id.*

80. *Id.* at 22.

covered every phase of the operations of investment companies and their management. These reports have been published by the Congress in several volumes under the title, *SEC Report on the Study of Investment Trusts and Investment Companies*. . . . [T]here was unanimous agreement that the evils and abuses disclosed in the Commission's reports required intervention through Federal legislation in "the national public interest and the interest of investors."<sup>81</sup>

Later, the Commission again recurred in its Brief to the congressional involvement in the elimination of sale-of-control premium-bribery:

The legislative history revealed that many abuses had resulted from the trafficking in management contracts. For such contracts were not only a lucrative source of income but also effective instruments of control. . . . [F]or the benefits of such control the sponsor or management was able to exact a substantial price from the purchaser.<sup>82</sup>

At another point in the Brief the Commission recognized the interrelation of Commission and Congress in pursuing the same objectives and philosophy:

[W]e do not, of course, lose sight of the fact that we are concerned here with a . . . legislative determination to extirpate the baneful trafficking in fiduciary contracts, the results of which had brought grief and disaster to public investors. . . . [T]he Congress intended to adopt measures equal to the task and purpose, so that the protection against these pernicious practices shall extend to all investors under all contingencies.<sup>83</sup>

#### 4. *The Corpus of the Commission Philosophy*

Faced with the self-imposed necessity of expressing the SEC stand in a cogent and coherent presentation in the Circuit Brief, the Commission elaborated its sale-of-control philosophy in five logical, cumulatively progressive arguments: (A) *The Custodial*

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81. *Id.* at 28.

82. *Id.* at 31-32.

83. *Id.* at 82, 83.

*Concept of Corporate Control; (B) The Suitability of the Successor Contrôleur; (C) The Premium-Bribe; (D) The Intrinsic Illegitimacy of the Premium-Bribe; (E) The Triple Sanction: Disgorgement, Damages, Dismissal.*

A. *The Custodial Concept of Corporate Control*

Pursuant to its congressional mandate and within the context of "historic equitable principles,"<sup>84</sup> the Commission began the erection of its control philosophy by an enunciation of the fundamental concept of 'fiduciary duty.' Essential to the ultimate liability of the Leach Group and the successor Kaiser Group—as with all *contrôleurs*—was the ultimate obligation of fiduciaries:

ISI clearly stood in a fiduciary relationship to the Trust Fund; and directors and officers, who were also controlling stockholders of ISI, stood in a like fiduciary relationship. As such, ISI and its directors and officers were under an affirmative duty to exercise their fiduciary responsibilities for the benefit of the Trust Fund and its public investors.<sup>85</sup>

Repeatedly, the Brief of the Commission sketched the broad perspective within which it viewed the responsibilities of the *contrôleur* of a mutual fund:

[I]n response to the growth of the modern corporation and its attendant complexities, courts of equity have exercised greater vigilance in the enforcement of fiduciary responsibilities, and equitable remedies have been correspondingly expanded to meet these developments. The same degree of vigilance and perception should be credited to the Congress . . . . Under the Act . . . one of the basic purposes was to strengthen and raise the level of fiduciary standards, not to weaken or lower it.<sup>86</sup>

Throughout, the Commission emphasized that its determination merely reflected:

[A] Congressional determination that the investment advisor and principal underwriter each occupies a fiduciary office in respect of the investment company; that his contractual agreement with the company constitutes an un-

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84. *Id.* at 17.

85. *Id.* at 16.

86. *Id.* at 21.



dertaking of a fiduciary character.<sup>87</sup>

And again: “[T]he investment advisory and principal underwriting agreements are not mere commercial arrangements but are, fundamentally, fiduciary undertakings.”<sup>88</sup>

### Custody, the Foundation of the Duty

Understandably, however, the Commission did not rest content with such fiduciary generalizations. Rather, it detailed and specified the fundamental substructure underlying these truisms. This is not to derogate in the least, however, from the efficacy and applicability of these broad “historic equitable principles”<sup>89</sup> and “fiduciary responsibilities.”<sup>90</sup> To the contrary, ‘the fiduciary duty of corporate control’<sup>91</sup> is a very real concept and outlines norms of conduct directly antithetical to the laxity and laissez-faire so prevalent over the last 75 years. “But to say that a man is a fiduciary only begins analysis,”<sup>92</sup> only states the problem, and the Commission knew this full well. Hence, it traced with some particularity the ultimate rationale of the fiduciary duty of the mutual-fund *contrôleur*, or of any other “trustees, receivers, administrators, guardians and corporate directors or officers,”<sup>93</sup> whomever, wherever. This ultimate rationale? The custody of the investors’ assets. Throughout its Brief, the Commission evinced a clear understanding that the final source of responsibility, and hence of fiduciary obligation, lay in the untrammelled custody of other people’s money, with the accent on ‘untrammelled.’

### Confidence/Reliance/Dependence

At that intense instant of appropriation, when the total corporate entity, all the assets, the future of the firm, pass into his hands, the *contrôleur* becomes a complete custodian. He becomes the ultimate power over the corporate destinies. This complete dominion corre-

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87. *Id.* at 44.

88. *Id.* at 18.

89. *Id.* at 17.

90. *Id.* at 21.

91. See D. BAYNE, *THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY* (1986).

92. *Securities & Exch. Comm’n v. Chenery Corp.*, 318 U.S. 80, 85-86 (1942).

93. *Securities & Exch. Comm’n v. Insurance Sec., Inc.*, 254 F.2d 642, 650 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958).

spondingly begets total entity dependence, with necessary reliance, and confidence, willy-nilly.<sup>94</sup>

Which is another way of saying that the genesis of all responsibility lies in the total dependence of the dependent entity on the independent entity. Over and over, the Commission drummed in this total dependence of the public investor and the corresponding total independence of the Leach and Kaiser factions:

It is conceded that ISI is the sponsor, manager, and investment advisor of the Trust Fund, as well as its principal underwriter; that ISI has no other business; and that the fees from the Trust Fund are the sole source of ISI's income. Since its organization in 1938, the Trust Fund has had no independent management of its own and ISI has performed all essential management functions for the Trust Fund.<sup>95</sup>

In this succinct paragraph, the Commission has set off the total *confidence*, *reliance* and *dependence* of the public investor and the totally "independent management" of the contrôleur.

The note of *dependence* is the element most expressive of the true status of one who reposes confidence in another. A dependent person is subject to, in the power of, another. This dependence is coterminous with the orbit of reliance or confidence. The dependence in the one finds the correlative independence in the other. It is a "relation of inequality."

No more ultimate constituent of the [custodial concept of corporate control] lies beyond or beneath this dependence.<sup>96</sup>

The Leach Group and later the successor Kaiser Group—through ISI—have "performed all essential management functions for the Trust Fund."<sup>97</sup> The concept of the 'submission to direction' was stressed: "[T]hose who are persuaded to buy investment company securities presumably do so on the assurance that their invested funds will be under the supervision and direction of a professional and expert management."<sup>98</sup>

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94. D. BAYNE, *supra* note 91, at 202.

95. Brief, *supra* note 30, at 16.

96. Bayne, *Corporate Control as a Strict Trustee*, 53 GEO. L.J. 543, 557 (1965).

97. Brief, *supra* note 30, at 16.

98. *Id.* at 49-50.

Regularly the Commission recurred to the innocent readiness of the public to entrust its money to others:

Investors who invested their money in the Trust Fund did not put their faith in an abstract corporate entity but in professional managers and in the expert direction they had undertaken to furnish to the investors.<sup>99</sup>

Here reiterated are all the ingredients of the *confidence/reliance/dependence*, the sole foundation of the custodial concept of corporate control. Here the public investors handed over their money to "professional managers" and "put their faith" in the unfettered and "expert direction they had undertaken to furnish." To "put their faith" in Leach and Kaiser was to repose in them the fullest *confidence* in the management of their money. Thus their *reliance* was complete. Since these powerless investors had no control whatsoever over their \$215 million, their *dependence* was patently total.

At another point, the Commission adverted consciously to the all-important *reliance*:

[I]nvestors who bought securities of investment companies generally had been persuaded to *rely* on the vaunted skill and experience of the sponsor and his associates . . . .<sup>100</sup>

Correlatively, the Commission emphasized the voluntary undertaking by the custodian:

[T]he investment advisor and principal underwriter each occupies a fiduciary office in respect [to] the investment company; . . . his contractual agreement with the company constitutes an undertaking of a fiduciary character.<sup>101</sup>

Often the Brief stressed the willing assumption of the duty: "Here you have a situation where a person assumes a fiduciary obligation; he is the manager of other people's money."<sup>102</sup> And again: "[T]he investment advisor, having undertaken to discharge the company's commitments to its investors, necessarily assumes a role that is managerial in function as well as in

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99. *Id.* at 23.

100. *Id.* at 36 (emphasis added).

101. *Id.* at 44.

102. *Id.* at 44 (quoting *Senate Hearings, supra* note 1, at 253 (statement of David Schenker)).

obligation.”<sup>103</sup>

### The Resultant Fiduciary Duty

The inexorable consequent—perhaps even corollary—of this total *confidence/reliance/dependence* is the total fiduciary responsibility engendered in the independent *contrôleur* who advertently and freely undertakes “the expert direction” and “‘management of other people’s money.’”<sup>104</sup> This conscious assumption of custody was repeated, emphasized by the Commission: The Leach and Kaiser Groups had voluntarily “*undertaken* to furnish to the investors”<sup>105</sup> “vaunted” “expert direction,” and had held themselves out as “professional managers.”

The essence of custody is the confidence-reliance-dependence carried to the maximum in the formal appropriation of the asset to the trustee.

Beginning with this dependence, therefore, the reasoning moves one uncontroverted step forward to the elemental conclusion: *Dependence begets responsibility.*<sup>106</sup>

This total dependence on the one side and total independence on the other led the Commission to the logical conclusion: In no way could Leach or Kaiser and their respective minions—or any *contrôleurs* of other people’s money—“escape from their self-assumed fiduciary obligations to the Trust Fund and its investors.”<sup>107</sup>

Because this dependence is total in the complete appropriation of the fund—a total tenure tantamount to title plus acquiescence in the stewardship status—the resultant responsibility is total.<sup>108</sup>

From this the Commission moves logically to the culminating conclusion that the fiduciary duty of corporate control flows indisputably from this total dependence: The Leach and Kaiser Groups—through ISI—“clearly stood in a fiduciary relationship to the Trust Fund.”<sup>109</sup>

In its conscious recognition of this total depen-

103. *Id.* at 50.

104. *Id.* at 23, 45.

105. *Id.* at 23 (emphasis added).

106. Bayne, *supra* note 96, at 564.

107. Brief, *supra* note 30, at 23.

108. Bayne, *supra* note 96, at 565.

109. Brief, *supra* note 30, at 16.

dence/independence with the resultant fiducial obligations, the Commission had established the ultimate principle of its control philosophy. This principle is a perfectly explicable proposition and alone would lead the Commission willy-nilly to a cohesive philosophy embodying all the consequent subprinciples and corollaries. With this the Commission had laid the foundation for the Custodial Concept of Corporate Control:<sup>110</sup>

At the base of the entire philosophy of corporate control lies this concept of custody. The ownership, in whatever form it may be organized, entrusts the corporate entity—either voluntarily or not—into the care and stewardship of the *contrôleur*. This act of appropriation effects a complete separation of ownership from control and results in the absolute dominion of the office of *contrôleur* over the totality of corporate assets. The *contrôleur* thus becomes the ultimate, top-level power in the corporate hierarchy.<sup>111</sup>

“Since the scope of [the *contrôleur*’s] responsibility is coterminous with the extent of the custody, it follows that the responsibility of [the *contrôleur*] is total because [the totality of the public investment] has been entrusted to [the *contrôleur*].”<sup>112</sup>

### Strict Trust

As early as the 1940 SEC Report, the Commission had concluded that the confidence/reliance/dependence of total custody led necessarily to the age-old strictures of the law of strict trust. The Report sought support from *Moulton v. Field*,<sup>113</sup> a prototypical strict-trust case: “[T]he courts have held that the holder of a management contract with a corporation occupies a position of trust . . . .”<sup>114</sup> Two years later, in the 1942 Opinion of the Commission’s General Counsel, the Commission reiterated its position and equated the role of a corporate director with that of a trustee:

In my opinion the legal status of an investment adviser is

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110. First propounded in Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963) [hereinafter Bayne, *A Philosophy*], and Bayne, *supra* note 96.

111. Bayne, *A Legitimate Transfer of Control: The Weyenberg Shoe-Florsheim Case Study*, 18 STAN. L. REV. 438, 442 (1966).

112. Bayne, *A Philosophy*, *supra* note 110, at 33.

113. 179 F. 673 (7th Cir. 1910).

114. REPORT, *supra* note 11, at 1090 n.62.

similar to that of a trustee of a trust or a director or officer of a corporation, and the investment adviser is under the same [obligations].<sup>115</sup>

Note well that the equitable rigors of strict-trust law were consciously embodied by the Congress in the 1940 Act by frequent references to liability for "gross abuse of trust."<sup>116</sup>

By 1957, the Commission position was further crystallized. The Brief refers to "the fundamental principle that management controls and prerogatives are powers in trust"<sup>117</sup> and to "the historic trust obligations prescribed by courts of equity."<sup>118</sup> Over some dozen pages, the Brief has resort to a long line of well-known strict-trust cases beginning with *Sugden v. Crossland*,<sup>119</sup> in 1856 through *McClure v. Law*,<sup>120</sup> *Moulton v. Field*,<sup>121</sup> *Porter v. Healy*,<sup>122</sup> and on down to the fifties. Thus: "Trustees of corporations owe duties to others besides themselves; they have been placed in a position of trust by the stockholders, and to those stockholders they must be faithful."<sup>123</sup> Later the Commission singles out strict-trust terminology from the famous *Perlman v. Feldmann* decision, referring to "'the necessary undivided loyalty owed by the fiduciary to his principal.'"<sup>124</sup>

Nor was the Commission unmindful that the Congress had incorporated these rigorous trust strictures into the Act:

Since the Congress could not in detail proscribe every means or device by which a faithless fiduciary might exploit his position of trust for his own account and benefit, the broad and inclusive provisions of Section 36 and the equitable principles embodied therein are of central importance in the enforcement of fiduciary standards.<sup>125</sup>

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115. Opinion of General Counsel of Commission, Securities & Exch. Comm'n, Investment Company Act Release No. 40-354, [1941-1944 Dec.] Fed. Sec. L. Rep. ¶ 75,281, at 75,698 (May 11, 1942).

116. *Id.*

117. Brief, *supra* note 30, at 36.

118. *Id.* at 78.

119. 3 Sma. & Giff. 192, 65 Eng. Rep. 620 (V.C. 1856).

120. 161 N.Y. 78, 55 N.E. 388 (1899).

121. 179 F. 673 (7th Cir. 1910).

122. 244 Pa. 427, 91 A. 428 (1914).

123. Brief, *supra* note 30, at 58 (quoting *Forbes v. McDonald*, 54 Cal. 98, 100 (1880)).

124. *Id.* at 20 (quoting *Perlman v. Feldmann*, 219 F.2d 173, 176 (2d Cir. 1955)).

125. *Id.* at 18.

The Benefit to Beneficiary Rule<sup>126</sup>

“The first of the two major trust concepts [that is, custody] is the cause of the second: All benefit from the administration of the trust must redound to the beneficiary”:<sup>127</sup>

ISI clearly stood in a fiduciary relationship to the Trust Fund . . . . As such, ISI and its directors and officers were under an affirmative duty to exercise their fiduciary responsibilities for the benefit of the Trust Fund and its public investors. Neither ISI nor its directors and officers could exploit their position for their personal gain.<sup>128</sup>

Later, the Commission confirms the rule:

Under equitable principles “the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation . . . .”<sup>129</sup>

In most recent years, even modern courts have continued to apply the doctrine of strict trust to a limited area of cases. The so-called ‘corporate opportunity’ rule is nothing other than strict trust applied to a somewhat narrow area of the law.<sup>130</sup> The Commission conjoins the terminology of ‘corporate opportunity’ to that of the benefit-to-beneficiary rule, in its interdict issued to Leach, Kaiser et aliis:

[T]hose in control of ISI could not appropriate [any cor-

126. Bayne, *supra* note 96, at 563.

127. D. BAYNE, *supra* note 91, at 53.

128. Brief, *supra* note 30, at 16.

129. *Id.* at 20 (quoting *Perlman v. Feldmann*, 219 F.2d 173, 176 (2d Cir. 1955)).

130. The doctrine of corporate opportunity is not new to our law. It is only one phase of the cardinal rule that requires undivided loyalty from corporate fiduciaries. . . .

Directors and officers of a corporation are fiduciaries. They are the trustees of its business and property. In this capacity, they are subject to the general rule of trusts and trustees . . . .

*Kerrigan v. Unity Sav. Ass'n*, 11 Ill. App. 3d 766, 773-74, 297 N.E.2d 699, 704-05 (1973), *aff'd in part, rev'd on other grounds in part*, 58 Ill. 2d 20, 317 N.E.2d 39 (1974); *see also Borden v. Sinskey*, 530 F.2d 478 (3d Cir. 1976); *Abbott Redmont Thinlite Corp. v. Redmont*, 475 F.2d 85 (2d Cir. 1973); *Holden v. Construction Mach. Co.*, 202 N.W.2d 348, 358 (Iowa 1972); *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974).

Most ‘corporate opportunity’ cases have ultimate recourse to the classic case, *Guth v. Loft, Inc.* 23 Del. Ch. 255, 5 A.2d 503 (1939).

porate] opportunity for themselves, but, as fiduciaries, must exercise it for the benefit of the investors in the Trust Fund.<sup>131</sup>

In simple English, the public investors of the Trust Fund would have deeply enjoyed the opportunity to net \$4.37 million for the transfer of the management of *their* \$215 million in assets. As authority for this 'corporate opportunity' corollary of the benefit-to-beneficiary rule, the Commission cited the oft quoted strict-trust case, *Irving Trust Co. v. Deutsch*, "holding that [the] directors, as fiduciaries, may not intercept or appropriate for their own account a transaction which should be available for the benefit of the corporation."<sup>132</sup> The Commission concluded this 'corporate opportunity' discussion with reference to *Pertman v. Feldmann*:<sup>133</sup> "The appropriation of that advantage for their own account did 'not betoken the necessary undivided loyalty owed by the fiduciary to his principal.'"<sup>134</sup> Toward the end of the Brief the Commission again imposes on Leach and Kaiser the mandates of the benefit-to-beneficiary rule: "Its services are essentially of a fiduciary character, and, as trustee, ISI may continue to render these services . . . only for the purpose of discharging its obligations to the Trust Fund, and for no other."<sup>135</sup>

#### B. *The Suitability of the Successor Contrôleur*

Moreover, the *contrôleur's* broad fiduciary duty can be broken down into three component obligations: (1) establishing the best possible corporate structure, (2) maintaining the most enlightened managerial policy, and (3) selecting the most competent personnel.<sup>136</sup>

"Among the multitude of duties stemming from the broad fiduciary obligation," and the corollary benefit-to-beneficiary rule, "possibly the most important (and from the standpoint of the study of control the most prolific of insight) is the *contrôleur's* final obligation: to appoint his successor. However im-

131. Brief, *supra* note 30, at 49.

132. *Id.* at 49 n.34 (citing *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2d Cir. 1934), *cert. denied*, 294 U.S. 708 (1935)).

133. 219 F.2d 173, 176 (2d Cir. 1955).

134. Brief, *supra* note 30, at 49 (quoting *Pertman v. Feldmann*, 219 F.2d 173, 176 (2d Cir. 1955)).

135. *Id.* at 96.

136. Bayne, *supra* note 111, at 443.



portant may be his day-to-day and year-to-year performance, his last official act can well shape the entire future of the corporation."<sup>137</sup>

From the aspect of either contrôleur or successor, therefore, the rule is clear: The benefit to beneficiary and the suitability of the appointee are the only legitimate considerations at the time of the appointment. Suitability is the sole final cause that may flow legitimately into the selection of the new contrôleur.<sup>138</sup>

The Commission was fully cognizant of these elemental concepts and knew, moreover, that the sale of control was simply the appointment of a successor contrôleur for a price. "What is sold is the occupancy [of the office], and the price paid for the occupancy is the premium-bribe."<sup>139</sup>

The Commission again used *Moulton v. Field*, one of the leading strict-trust sale-of-control cases. Thus the Commission's Brief:

If the succession [to control] was worth \$125,000 in the market, the sale (if it were lawful) should have been made by the directors for the benefit of the owners of the business, not of Gray. For Gray had nothing legally saleable. . . . So the arrangement . . . by which the office . . . and . . . control were sold . . . and the consideration turned over to Gray instead of into the treasury, was a betrayal of trust.<sup>140</sup>

And again, with resort to the equally famous *Porter v. Healy*,<sup>141</sup> the Brief stressed that considerations of dollars rather than considerations of successor suitability rendered the contract a nullity and resulted in premium-bribery rather than a legitimate appointment of a new contrôleur.

Courts of equity have enforced the same principle [that the contract was void as against public policy] when

137. *Id.*; see also Bayne, *The Sale of Corporate Control*, 33 *FORDHAM L. REV.* 583, 591-92 (1965).

138. Bayne, *The Sale-of-Control Premium: The Intrinsic Illegitimacy*, 47 *TEX. L. REV.* 215, 221 (1969).

139. Bayne, *The Sale-of-Control Premium: The Definition*, 53 *MINN. L. REV.* 485, 494 (1969).

140. Brief, *supra* note 30, at 60 (quoting *Moulton v. Field*, 179 F. 673, 675 (7th Cir. 1910)).

141. 244 Pa. 427, 91 A. 428 (1914).

the fiduciary or corporate office has been sold as part of a package which formally appeared as a sale of stock control . . . . Directors or officers have been held liable for breach of trust when, upon the evidence, it appeared that the excess “was not so much a part of the price paid for the stock owned or controlled by the defendants as a secret consideration paid to them for the purpose of gaining immediate control of the organization of their corporation.”<sup>142</sup>

Against this background, the Commission specifically interdicted the ISI sale of control:

In substance, the Commission views the transaction as only nominally a sale of stock. The unique and substantial “asset”, for which the purchasers paid about \$4,000,000, is the succession to ISI’s contractual and fiduciary arrangements with the Trust Fund, which ISI and the directors-defendants cannot sell either directly or in the guise of a premium on ISI stock.<sup>143</sup>

The Commission at this early stage in the legal history of the development of a philosophy of corporate control—in the fifties, commentary was sparse<sup>144</sup>—showed impressive prescience in conjoining the ‘appointment of the successor’ to the benefit-to-beneficiary rule:

[T]he privilege of choosing a successor adviser or underwriter rests with the Trust Fund and its investors. . . . [T]hose in control of ISI . . . must exercise it for the benefit of the investors in the Trust Fund.<sup>145</sup>

### Conflict of Interest

The Commission was demonstrably conscious that a conflict of interest was invariably present when the incumbent contrôleur—say the Leach Group—negotiated the appointment of a successor contrôleur—say the Kaiser Group—based on the

142. Brief, *supra* note 30, at 61 (quoting *Porter v. Healy*, 244 Pa. 427, 432, 91 A. 428, 430 (1914)).

143. *Id.* at 45.

144. The Commission cited only three commentaries: Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957); Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1 (1956); Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725 (1956). Brief, *supra* note 30, at 61.

145. Brief, *supra* note 30, at 49.

amount of premium-bribe dollars rather than on the successor's suitability to manage the helpless assets—say \$215 million—of the helpless public investors. The Commission knew that a conflict of interest was intrinsic to the breach of loyalty which lay at the heart of a trustee's 'trafficking in the trust.' Consistently throughout the Brief, the Commission recurred to this conflict of interest. Thus, in an excerpt from the 1938-1940 SEC Report:

The shift in control was a private negotiation between the acquiring corporation . . . and the retiring management . . . .

Such shifts in control were usually advantageous to the retiring managers. Consequently, minority stockholders of these companies were represented in the shift of control . . . only by sponsors and managers who may have been pecuniarily interested . . . .<sup>146</sup>

Midway in the Brief, the logical progression from breach of fiduciary duty to conflict of interest became even more patent:

There is no need to dilate upon the evils and abuses involved in these practices [of trafficking in the trust]. It is elementary that such practices are wholly at variance with the fundamental principle that management controls and prerogatives are powers in trust, and as such are not to be bought and sold in the market place as the personal effects of the individual managers. It is also evident that trading in fiduciary relationships necessarily involves conflicts of interest which are not likely to be resolved in favor of the beneficiaries.<sup>147</sup>

At this point resort to another, lesser-known strict-trust case, *Kratzer v. Day*,<sup>148</sup> will add to one's understanding of the SEC position on sale-of-control conflict of interest. The Commission had resort to *Kratzer* in its excoriation of the Milton/Odlum/Groves trio: "A fiduciary may not place himself in a position where he may be tempted to favor his own undisclosed interest at the expense of those who have placed their trust in him."<sup>149</sup>

Thus, the Commission throughout the Brief has shown its

146. *Id.* at 32-33 (quoting from Report, *supra* note 33, at 1029-30).

147. *Id.* at 36.

148. 12 F.2d 724 (9th Cir. 1926).

149. REPORT, *supra* note 11, at 1092 n.69 (citing *Carlisle v. Smith*, 234 F. 759 (D. Ga. 1916); *Horbach v. Coyle*, 2 F.2d 702 (8th Cir. 1924); *Kratzer v. Day*, 12 F.2d 724 (9th Cir. 1926)).

dedication to “two controlling truths: The Conflict-of-Interest Rule (1) is ultimately dictated by custodial tenure and (2) is a sub-rule derived directly from the basic loyalty of the benefit-to-beneficiary principle. It is essentially and inevitably related to these first two major trust concepts.”<sup>150</sup>

### C. *The Premium-Bribe*

As early as 1940, the Commission had evolved a general understanding of the nature of the premium-bribe. True, there were inconcinnities in the exposition, but except for an occasional frailty the Commission could claim a solid appreciation of the concept. Indeed, it is intriguing to watch the Commission shade the various nuances of the definition as it developed its four-year Study, culminating in the 1940 SEC Report. Using the foundation of this Report, the Commission was able to erect a convincing definition of the premium-bribe in its ISI Brief.

The redoubtable David Schenker, chief counsel for the Study, recounted in his Senate testimony—toward the drafting of the Investment Company Act of 1940—a vivid tale of a characteristic approach to the barter of the office. Here the public investor held senior, nonvoting securities.

In the early part of 1938, . . . a person . . . came to me and said, “I am going to sell control of this investment trust to Mr. So-and-so.”

You would think . . . that he owned that investment trust. What he had was some of this tricky management stock . . . . The fact of the matter is his stock had absolutely no asset value and all of the assets really belonged to the senior security holders. Yet he was going to sell the trust.

. . . .

He said, “Well, we are going to get \$2,000,000,” which was a \$2,000,000 premium on the stock, Senator, . . . his stock was worth nothing, you see.”

. . . “Anybody who will pay you . . . two million dollars for stock that is under water 50 dollars a share must have some fancy ideas. . . .”

He said, “He is going to buy the control block of stock. Simultaneously I am going to turn over the board

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150. D. BAYNE, *supra* note 91, at 73.

of directors to him.”<sup>151</sup>

But some preparatory commentary is necessary to point up the Commission’s success in penetrating this elusive concept, and help chart the Commission’s path.

### The Premium in Perspective

A major source of misconception has been the failure to lay bare the mechanics of the sale of control and the place of the premium-bribe. . . . [B]egin with two basic premises: (1) Every transfer of control, of whatever kind, is very simply the appointment of a new person to the office of *contrôleur*. For some reason the incumbent is leaving. He finds a willing successor. Control has been transferred. (2) Every transfer of control is not a sale of control, but every sale is a transfer. The ‘sale’ is a limited species of the genus ‘transfer’—the sale is a transfer for a price. The sale, in effect, adds only one new element—the premium paid for the appointment. Never does a nonsale transfer directly involve money passing from appointee to *contrôleur*.<sup>152</sup>

Notably, the Commission had grasped this focal point: The sale of control “is very simply the appointment of a new person to the office of *contrôleur*.” Thus the Brief:

Neither ISI nor its management could dispose of ISI’s fiduciary arrangements with the Trust Fund, and the selection of a successor rested exclusively with the Trust Fund and its investors under Section 15. To the extent that a purchaser was willing to pay a substantial sum for the privilege of succeeding to the contracts, those in control of ISI and in a strategic position to dictate or influence the course of the succession could not appropriate that opportunity for their own benefit.<sup>153</sup>

It would be best to consider the Commission’s understanding of the premium-bribe concept in the background of a more formal statement of the technical definition of the premium-bribe:

Broken down into its five principal parts, the sale-of-

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151. *Senate Hearings, supra* note 1, at 54.

152. *Bayne, supra* note 139, at 493.

153. *Brief, supra* note 30, at 19-20.

control premium-bribe can thus be technically defined as (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*.<sup>154</sup>

Toward the formal enunciation of the Commission's definition of the premium-bribe, the four principal elements—the fifth, *scienter*, goes without saying since even the most pedestrian premium-briber usually knows what he is doing, or should—will be assembled one by one in logical order, through appropriate resort to the major Commission documents.

#### “Some Form of Consideration”

Among the knottier problems in the detection of a premium-bribe has been the isolation of “some form of consideration, monetary or otherwise.” Generally the parties to a sale of control try to hide the premium-bribe dollars in a concomitant stock sale.<sup>155</sup> Even the competent Judge Swan, dissenting in the important sale-of-control *Perlman v. Feldmann*, stumbled over this isolation problem:

The controlling block could not by any possibility be shorn of its appurtenant power to elect directors and through them to control distribution of the corporate product. It is this “appurtenant power” which gives a controlling block its value as such block. What evidence could be adduced to show the value of the block “if shorn” of such appurtenant power, I cannot conceive, for it cannot be shorn of it.<sup>156</sup>

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154. Bayne, *supra* note 139, at 497.

155. The Brief alluded to the situation where *no* such difficult isolation would be needed, as rare as such a case might be.

When the transaction involves the sale of the office or the management contract alone, unaccompanied by a sale of stock, these complexities are not present. Then the very act of sale constitutes the breach of trust and the purchase price itself is the measure of the fiduciary's liability.

Brief, *supra* note 30, at 65. The Commission instanced *Sugden v. Crossland*, 3 Sma. & Giff. 192, 65 Eng. Rep. 620 (V.C. 1856), and *Moulton v. Field*, 179 F. 673 (7th Cir. 1910), as examples in which no isolation was required since the consideration stood alone.

156. *Perlman v. Feldmann*, 219 F.2d 173, 180 (2d Cir.) (Swan, J., dissenting), *cert. denied*, 349 U.S. 952 (1955).

But the Commission, showing much more prescience than Judge Swan, *could* “conceive,” correctly, how “the value of the block” could be “shorn” from the element of control. The ISI Brief is a valuable lesson to any court, as well as a forceful statement by the Commission:

In the Commission’s view, the transactions in the instant case were much more than a sale of stock . . . . [S]tock control of ISI was sold by its directors, officers and majority stockholders at \$50 per share although the net asset value of the stock was below \$2 per share. It is further alleged that the price paid did “not represent the real and actual value” of the ISI shares and that it “represented no payment for any asset or assets” owned by ISI. The unique and substantial “asset” for which the purchasers paid about \$4,000,000, was the opportunity to succeed to ISI’s contractual and fiduciary arrangements with the Trust Fund . . . .<sup>157</sup>

That was in 1956, but two decades earlier in the four-year study released in the 1938-1940 SEC Report the Commission had already segregated the ‘consideration’ requisite of the definition of the premium-bribe: (The Commission was speaking of the sale of control of an investment trust by the investment advisers as an alternative to a dissolution which would have resulted in the more equitable distribution of the fund’s assets to the owners, the senior security holders.)

Sponsors and managers . . . would have received nothing in the event of a dissolution. The alternative of selling their common stock, worthless in asset value but valuable as controlling the corporate assets belonging to senior security holders, was obviously more attractive.<sup>158</sup>

At another point in the Brief, the Commission gathered support for its isolation of the ‘consideration’ factor of the premium-bribe by several—five in all—factual illustrations culled from various parts of the 1938-1940 SEC Report:

Several techniques were employed in the sale of management control. In some cases, compensation was paid for the direct assignment of the contract. In other

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157. Brief, *supra* note 30, at 19.

158. REPORT, *supra* note 11, at 1023.

cases, payment for the assignment was reflected in the premium paid in the purchase of blocks of the investment company's capital stock held by the management. In still others, when the manager or sponsor was a corporation, rather than a partnership or a sole proprietor, control of the contract was obtained by purchasing the stock of the management or service company at a substantial price, although the stock had little or no asset value apart from the contract and the incidents of control that went with it.<sup>159</sup>

Patently a premium-bribe can hide behind many guises and pass in an infinite variety of ways.

Repeatedly throughout the 1938-1940 SEC Report and the years of testimony, the Commission spotlighted the element of consideration: "[T]he acquiring . . . individual purchased from those in control their common stocks with negative asset value at prices far in excess of their nominal market value."<sup>160</sup> And, as was commonplace: "[The] acquisition . . . encompassed . . . the purchase of the shares . . . held by the public at prices less than the asset value of such shares . . . ."<sup>161</sup>

The sale-of-control history has uncovered only two looting cases—cases in which the premium-bribers first bought control and *then* looted the controlled company—the *Reynolds*<sup>162</sup> cases and *Insuranshares Corp. v. Northern Fiscal Corp.*<sup>163</sup> The Commission relied on both cases at various points in the ISI argumentation, but *Insuranshares* offers a particularly impressive expression of the difference between honest investment value of an accompanying block of stock and the dollar value of the premium-bribe which, perhaps fortuitously, happened to accompany the stock sale. The Brief quotes the court, appositely:

The defendants have insisted throughout the case that the transfer of December 21, 1937, was simply a sale of stock, the passing of control being merely a normal

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159. Brief, *supra* note 30, at 34-35 (footnotes omitted).

160. REPORT, *supra* note 11, at 1086.

161. *Id.* at 1024.

162. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622 (Sup. Ct. 1941); *Gerdes v. Reynolds*, 30 N.Y.S.2d 755 (Sup. Ct. 1941); *Ballantine v. Ferretti*, 28 N.Y.S.2d 668 (Sup. Ct. 1941); *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741 (1960).

163. *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940); *Insuranshares Corp. v. Northern Fiscal Corp.*, 42 F. Supp. 126 (E.D. Pa. 1941).



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. . . . 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.<sup>164</sup>

Thus the Commission has successfully segregated unexplained dollars—dollars, that is, that cannot be accounted for legitimately, say as gift or debt—which can be explained only as “some form of consideration, monetary or otherwise.” Which leads to the second of four requisites of the Commission’s definition of the premium-bribe.

#### “Flowing to the Incumbent Contrôleur”

In the main, the Commission assumed that the destination of the premium-bribe dollars was the outgoing contrôleur. Thus, in *Insuranshares*, the Commission saw no need to highlight the fact that the incumbent received the premium-bribe, and stated simply that “ ‘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.’ ”<sup>165</sup>

But at times there did seem to be Commission emphasis—albeit not overwhelming—on this second essential element to the premium-bribe. After all, if the incumbent contrôleur did not receive the “consideration, monetary or otherwise,” a premium-bribe could scarce be attributed to anyone. The 1938-1940 SEC Report was sufficiently explicit:

The common method of acquiring control of a company is the purchase of the controlling blocks of stock held by the company’s . . . “insiders” at a price representing a substantial premium over the market value . . . .

164. Brief, *supra* note 30, at 47-48 (quoting *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22, 24 (E.D. Pa. 1940)).

165. *Id.* at 48 (quoting *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22, 24 (E.D. Pa. 1940)).

In nearly all . . . cases the price was substantially in excess of the consideration . . . paid . . . to minority holders . . . in the course of a program to absorb eventually the assets of the acquired company.<sup>166</sup>

Restrained understatement nonetheless left no doubt that the premium-bribe dollars must find their way to the pockets of “the vendors of control,” or no premium-bribe. From the results of the four-year Study in the 1938-1940 SEC Report:

In other cases, however, the shifts in control and the amalgamation of investment companies were inspired by motives of pecuniary gain to the vendors of control which were not necessarily consonant with the interest of the public investors.<sup>167</sup>

Next came the third, patent but essential, element of the premium-bribe.

“From or on Behalf of the Prospective Contrôleur”

These various requisites of a premium-bribe may seem palpably self-evident, but the Commission—and any sale-of-control scholar—knows that every element is essential to any arguable liability for premium-bribery, self-evident or no. The Brief is typically assertive:

It is also incontestable doctrine that a fiduciary, while he may resign at will, may not accept payment from one who wishes to succeed to his position . . .<sup>168</sup>

And in the same vein at an earlier point in the Brief:

To the extent that a purchaser was willing to pay a substantial sum for the privilege of succeeding to the contracts, those in control of ISI and in a strategic position to dictate or influence the course of the succession could not appropriate that opportunity for their own benefit.<sup>169</sup>

Again, the Brief has resort to the Second Circuit *Feldmann*:

[T]he receipt of substantial payments for the succession

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166. REPORT, *supra* note 11, at 1092-93.

167. *Id.* at 1019.

168. Brief, *supra* note 30, at 20.

169. *Id.*

in this case is inconsistent with the necessary undivided loyalty [owed] by the fiduciary to his principal.<sup>170</sup>

In New York, *Benson v. Braun*<sup>171</sup>—a lesser sale-of-control case—the Commission used the court to elaborate somewhat on this third requisite of premium-bribery:

[F]iduciaries had sold control by the sale of stock at a price far in excess of its fair value “on the theory that the said excess was paid for the resignations, for the election of the purchasers’ nominees, and for immediate control of the corporation.”<sup>172</sup>

The Commission’s Brief also attempted to impute to the Congress the intent to proscribe the payment of premium-bribe dollars by the would-be *contrôleur*.

Since Congress declared that these fiduciary offices were not objects of sale and that aspirants to such offices were subject to election, payment to the present management or those in control for the succession is forbidden under equitable doctrines which courts of equity have enforced for at least one hundred years . . . .<sup>173</sup>

#### “To Induce the Appointment to the Office of Control”

The last of four essentials—recall that the fifth, *scienter*, requires no present analysis—is the most important. Grant that (1) “the consideration, monetary or otherwise” has already passed (2) “to the incumbent *contrôleur*” and (3) has been proven to have been passed by “the prospective *contrôleur*,” nevertheless, unless (4) the purpose of that payment is to induce the appointment to control, any alleged liability for the tort of premium-bribery<sup>174</sup> will clearly fail. All four—as well as *scienter*—

170. *Id.* (quoting *Perlman v. Feldmann*, 219 F.2d 173, 176 (2d Cir. 1955)).

171. 8 Misc. 2d 67, 155 N.Y.S.2d 622 (Sup. Ct. 1956).

172. Brief, *supra* note 30, at 48 (quoting *Benson v. Braun*, 286 A.D. 1098, 1098, 145 N.Y.S.2d 711, 712 (1955)).

173. *Id.* at 76.

174. Some jurisdictions also provide criminal sanctions for commercial bribery. See ALA. CODE §§ 13A-11-120, -121 (1975); ALASKA STAT. §§ 11.46.660, .670 (1962); ARIZ. REV. STAT. ANN. § 13-2605 (Supp. 1987); COLO. REV. STAT. § 18-5-401 (1986); CONN. GEN. STAT. §§ 53a-160, -161 (1985); HAWAII REV. STAT. § 708-880 (1985); ILL. REV. STAT. ch. 38, ¶ 29A-1, -2 (1985); IOWA CODE § 722.10 (1985); KY. REV. STAT. ANN. §§ 518.020, .030 (Michie/Bobbs-Merrill 1985); LA. REV. STAT. ANN. § 14:73 (West 1986); MASS. GEN. LAWS ANN. ch. 271, § 39 (West 1970); MICH. COMP. LAWS § 750.125 (1979); MINN. STAT. § 609.86

are absolutely essential, but the *purpose to induce* is preeminent.

The Commission's resort in its Brief to *Insuranshares* is possibly the clearest exposition of this fourth and final element of the definition of the premium-bribe:

"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 . . . . 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."<sup>175</sup>

The same point was equally explicit in resort to *Benson v. Braun*:

[F]iduciaries had sold control by the sale of stock at a price far in excess of its fair value on the theory that the said excess was paid for the resignations, for the election of the purchasers' nominees, and for immediate control of the corporation.<sup>176</sup>

The Schenker testimony in the 1940 Senate Hearings, which led to the Investment Company Act of 1940, gave a cameo picture of the requisite 'to induce the appointment':

In the early part of 1938 . . . a person who controls an investment trust came to me and said, "I am going to sell control of this investment trust to Mr. So-and-so."

. . . .

He said, "he is going to buy the control block of stock. Simultaneously I am going to turn over the board

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(1984); MISS. CODE ANN. §§ 97-11-11, -13 (1972); MO. REV. STAT. § 570.150 (1978); NEB. REV. STAT. § 28-613 (1985); NEV. REV. STAT. § 207.295 (1957); N.H. REV. STAT. ANN. § 638:7 (1986); N.J. STAT. ANN. § 2C:21-10 (West 1982); N.Y. PENAL LAW. §§ 180.00, .05 (McKinney 1975); N.C. GEN. STAT. § 14-353 (1986); N.D. CENT. CODE § 12.1-12-08 (1985); 18 PA. CONS. STAT. ANN. § 4108 (Purdon 1983); R.I. GEN. LAWS §§ 11-7-3, -4 (1981); S.C. CODE ANN. § 16-17-540 (Law. Co-op. 1985); S.D. CODIFIED LAWS ANN. §§ 22-43-1, -2 (Supp. 1987); TEX. PENAL CODE ANN. § 32.43 (Vernon 1974); UTAH CODE ANN. § 76-6-508 (1987); VA. CODE ANN. § 18.2-444 (1982); WASH. REV. CODE ANN. §§ 49.44.060, .070 (1962); WIS. STAT. § 134.05 (1981-82).

175. Brief, *supra* note 30, at 47-48 (quoting *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22, 24 (E.D. Pa. 1940)).

176. *Id.* at 48 (citing *Benson v. Braun*, 286 A.D. 1098, 145 N.Y.S.2d 711 (1955)).

of directors to him. He then expects to liquidate the blue-chip portfolio, pay me for the control block . . . ."<sup>177</sup>

With this, the Commission has laid out all the essentials of a premium-bribe. But the questions now arise: So what? Is a premium-bribe so blameworthy? Are not premium-bribes a fact of daily life?

#### D. *The Intrinsic Illegitimacy of the Premium-Bribe*

One of the ironies in the history of legal thought is the regularly recurrent inability of even the sophisticated legal mind to apply age-old tried-and-true moral concepts to novel and complicated factual situations. A complex variant of a primitive swindle can often elude even a competent judiciary. So has it been with the illegitimacy of the sale of control. In the halcyon years of Anglo-Saxon jurisprudence, however, particularly during the second half of the 1800's, the courts of England—and by inheritance the courts in the United States—elaborated a refined body of sale-of-control law. Granted, the factual contexts were abecedarian. Nonetheless, the Anglo-American jurists came to grips with the problem of commercial premium-bribery with admirable finesse.<sup>178</sup>

The research work of Messrs. Meeker and Levy and their staff on the ISI Brief uncovered this refined body of sale-of-control law and presented to the courts and commentators a convincing line of cases, all of which pronounced premium-bribery inherently impermissible.<sup>179</sup>

The Brief began this historic line with the elemental *Sugden v. Crossland* in England in 1856. In *Sugden*, a trustee saw fit to accept

177. *Senate Hearings*, *supra* note 1, at 54.

178. For the principal, if not exhaustive, study of Anglo-American sale-of-control litigation, opinions and commentary, see generally D. BAYNE, *supra* note 91, at 389 (including supplementary tables).

179. A notable instance of the use of this line—conjecturally readily referable to the Commission's research—appeared in Judge Friendly's masterful *Rosenfeld v. Black*, undoubtedly the most significant sale-of-control opinion thus far.

We start from one of the "well-established principles of equity," recognized in *Insurance Securities* itself, . . . "that a personal trustee, corporate officer or director, or other person standing in a fiduciary relationship with another, may not sell or transfer such office for personal gain." There are ample authorities to support this proposition: *Sugden v. Crossland*, . . . *McClure v. Law*, . . . ; *Porter v. Healy*, . . . ; *Kratzer v. Day* . . . .

445 F.2d 1337, 1342 (2d Cir. 1971). Only those cases uncovered by the SEC Brief were retained in this excerpt from *Rosenfeld*.

£75 under the table to secure his resignation and the appointment of a successor to his position. The Vice-Chancellor reprobated this premium-bribery:

Horsfield abandoned his duty and office as trustee for a valuable consideration, and made over the trusteeship to a person who was deliberately excluded from that office by the testator. Such a transaction, as well as the instrument by which it was sought to be carried into effect, was entirely unjustifiable, and the deed, in accordance with the terms of the prayer, must be delivered up to be cancelled.<sup>180</sup>

Although the simplicity of *Sugden*—combined, of course, with its condemnation of premium-bribery—recommended itself as the bellwether case in the field, each of the succeeding cases offered the Commission a similar opportunity to expatiate on the intrinsic illegitimacy. The Brief, therefore, proceeded to present summaries and appropriate excerpts from each in the series: Following (1) *Sugden* came (2) *McClure v. Law*,<sup>181</sup> then (3) *Moulton v. Field*,<sup>182</sup> (4) *Porter v. Healy*,<sup>183</sup> and finally (5) *Perlman v. Feldmann*,<sup>184</sup> which was the most illustrious thus far.

Remember that the 20 years prior to the Commission's ISI Brief, 1936 to 1956, had produced only rudimentary study and commentary on the sale of control. This was especially true in the recondite area of the intrinsic illegitimacy of the premium-bribe. At this relatively early stage in the development of a philosophy of corporate control, courts and commentators had not yet reasoned beyond the stage of a general realization that somehow, for some valid but yet undefined reason, premium-bribery was inherently wrong and should not be tolerated.

Understandably, therefore, the Commission, albeit in the vanguard, could do no more than reflect the most refined thinking of the time. Yet, as early as the 1938-1940 SEC Report, the Commission had presented testimony, gathered over the four years, that even then had been adduced to support the Commission's oft stated thesis that premium-bribery was essentially untenable. In the reams of such testimony, one of the more telling

180. *Sugden v. Crossland*, 3 Sma. & Giff. 192, 193, 65 Eng. Rep. 620, 621 (V.C. 1856).

181. 161 N.Y. 78, 55 N.E. 388 (1899).

182. 179 F. 673 (7th Cir. 1910).

183. 244 Pa. 427, 91 A. 428 (1914).

184. 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955).

excoriations of premium-bribery was elicited during the public examination of the president of Interstate Equities Corporation. The testimony was in specific "reference to the practice of using the assets of acquired investment companies to purchase controlling blocks of the negative-asset-value common stocks of other investment companies at prices in excess of the market value of such stocks:"<sup>185</sup>

[A] minority . . . stock interest receives in practice no benefit of the premium [for control].

In my own judgment, it is only a question of time when . . . [the] theory of premium for control, will be exposed to the merciless criticism of public investigation . . . .<sup>186</sup>

Especially on the question of the basic illegality of premium-bribery, the Commission frequently interlarded the fact-gathering of the thirties—which, of course, was the principal objective of the four years of the Study—with dogmatic pronouncements supported by cases and commentaries. Here, more than elsewhere, one could discern the philosophical outline that would later emerge in the mid-fifties in the Commission's formal statements of its philosophy of corporate control. In the 1938-1940 SEC Report, the Commission used early New York opinions to carry its point:

[C]ontracts by which directors . . . expressly agree as an incident to the sale of their shares . . . to transfer the offices and directorships . . . , that is, to "barter away" the offices of the companies . . . are illegal as against public policy.<sup>187</sup>

In the late thirties—and even today in the case of many courts—the ultimate condemnation available to judge or writer was: "[I]llegal as against public policy."<sup>188</sup>

185. REPORT, *supra* note 11, at 1038 n.42.

186. *Id.* (quoting a letter written by Edward R. Tinker, first president of Interstate Equities Corp., July 27, 1932 (Public Examination, Interstate Equities Corp., Commission's Exhibit No. 24)).

187. *Id.* at 1029 n.27 (citing *Fennessy v. Ross*, 90 Hun. 298, 35 N.Y.S. 868 (Sup. Ct. 1895), 5 A.D. 342, 39 N.Y.S. 323 (1896); comparing *McClure v. Law*, 161 N.Y. 78, 55 N.E. 388 (1899)).

188. The opinion that placed Iowa as the only state jurisdiction to proscribe civil premium-bribery could adduce no reason for the proscription beyond: "The transaction was thus contrary to public policy. We have long held contracts contrary to public policy are unenforceable." *Rowen v. Le Mars Mut.*

Twenty years later, in the SEC Brief, the avowed purpose was no longer mere fact-finding but was rather the erection of a philosophy of corporate control, at least as applied to premium-bribery. Here, the Commission endeavored to flesh out the unadorned, and evasive, concept, 'illegal on account of public policy.' The Brief, understandably, sought to incorporate whenever possible the vast work of the 1936-1940 SEC Study:

Since Congress declared that these fiduciary offices were not objects of sale and that aspirants to such offices were subject to election, payment to the present management or those in control for the succession is forbidden under equitable doctrines which courts of equity have enforced for at least one hundred years, and of which, we may be sure, the Congress was aware when it enacted the broad and inclusive provisions of Sections 15 and 36. These equitable principles were discussed in the Commission's report of investigation with specific reference to the transfer of management contracts.<sup>189</sup>

Later, the Brief recurred to the strict-trust foundation of premium-bribe illegality.

There is no need to dilate upon the evils and abuses involved in these practices. It is elementary that such practices are wholly at variance with the fundamental principle that management controls and prerogatives are powers in trust and as such are not to be bought and sold in the market place as the personal effects of the individual managers. It is also evident that trading in fiduciary relationships necessarily involves conflicts of interests which are not likely to be resolved in favor of the beneficiaries.<sup>190</sup>

In its quest for a more ultimate rationale for the illegality of the premium-bribe, the Commission borrowed from *Pertman v. Feld-*

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*Ins. Co.*, 282 N.W.2d 639, 650 (Iowa 1979). Anent this usage, the popular quotation from the early English court remains worthy of repetition:

I, for one, protest, as my Lord has done, against arguing too strongly upon public policy;—it is a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail.

*Richardson v. Mellish*, 130 Eng. Rep. 294, 303 (C.P. 1824).

189. Brief, *supra* note 30, at 76 (referring to REPORT, *supra* note 11, at 1029, 1086).

190. *Id.* at 36.



*mann* which had expounded the best reasons thus far for such illegality:

Under equitable principles “the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it”, and the receipt of substantial payments for the succession in this case is inconsistent with “the necessary undivided loyalty [owed] by the fiduciary to his principal.” . . . It is also incontestable doctrine that a fiduciary, while he may resign at will, may not accept payment from one who wishes to succeed to his position . . . .<sup>191</sup>

The Commission, moreover, took pains to point out the radical difference between a legitimate transfer of control and a sale of control for a premium-bribe:

It is when the sale of control involves receipt of consideration for the succession to these fiduciary offices that in our view, the sale constitutes . . . “gross abuse of trust” . . . .<sup>192</sup>

The Court in the 1880 California case, *Forbes v. McDonald*<sup>193</sup>—prominent in the historic sale-of-control line—added a fundamental explanation of the philosophical rationale of the illegitimacy by interdicting the sale of control as essentially ‘against good morals.’ This may be thought to be no more fundamental than ‘illegal as against public policy,’ but the Commission nonetheless thought that the approach added to an understanding of the illegitimacy:

“It is *contra bonos mores*. Trustees of corporations owe duties to others besides themselves; they have been placed in a position of trust by the stockholders, and to those stockholders they must be faithful. It is a violation of that trust for them to be bought out of office. They may resign when they please, but they must not make profit or benefit themselves in the matter of such

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191. *Id.* at 20 (quoting *Perlman v. Feldmann*, 219 F.2d 173, 176 (2d Cir. 1955)).

192. *Id.* at 69.

193. 54 Cal. 98 (1880).

resignation.”<sup>194</sup>

In a word, the Commission’s research—spanning the 20 years 1936-1956—was superb. Not only did the Commission construct an embryonic philosophy of the intrinsic illegitimacy of the premium-bribe, but that philosophy was tenable, cohesive and unvarying over the period.

In no wise is it in derogation of the Commission’s work to suggest that the ultimate rationale of this intrinsic illegitimacy lay in the culminating statement of a lengthy 1969 study:

The totality of the turpitude of the premium-bribe consists of three conceptually distinct elements caused by separate breaches of fiduciary duty, each with its own peculiar contribution and coalescing into a distinctive moral unit. This tripartite illegitimacy could be defined as:

(1) *The perversion of the judgment of the incumbent controller, 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.*

This technical definition states the major thesis [of the rationale].<sup>195</sup>

Perhaps this aspect of this ‘open letter’ could serve the Commission for the future.

#### E. *The Triple Sanction: Disgorgement, Damages, Dismissal*

In the light of the painstaking effort in constructing the long line of Commission argumentation thus far elaborated, the Commission’s emphasis on the consequent sanctions was almost perfunctory. The ISI complaint lumped them all in one summary request. The Commission sought:

. . . a permanent injunction to restrain the [Kaiser Group] from serving as officers and directors of ISI and from serving and acting as directors of the proposed board of directors of the Trust Fund, and ISI from acting as investment adviser and principal underwriter of the

194. Brief, *supra* note 30, at 58 (quoting *Forbes v. McDonald*, 54 Cal. 98, 100 (1880)).

195. D. BAYNE, *supra* note 91, at 204-05.

Trust Fund; and an accounting for the monetary benefits which the [Leach Group] wrongfully and inequitably obtained as a consequence of the sale of their ISI stock.<sup>196</sup>

For purposes of clarity and ease of understanding, the Commission's sought-for sanctions will be explored in their three divisions.

i. *Disgorgement*

Whereas one might argue that the Commission did adduce a convincing rationale for the intrinsic illegitimacy of the premium-bribe, on the question of the rightful ownership of those premium-bribe dollars—albeit ab initio illegitimate—once paid over to the would-be contrôleur, the Commission proceeded little beyond mere assertion and allegation:

[T]he payment for stock control at \$50 per share, as against net asset value of \$1.81 per share, represent[ing] . . . an asset of the Trust Fund, equitably belongs to the Trust Fund.<sup>197</sup>

Beyond the assertion that this premium-bribe is “an asset of the Trust Fund,” the Commission makes little effort to establish the reasons why the \$4.37 million is a Trust Fund asset.

Perhaps this is harsh, because the Commission does make good use of its historical line of sale-of-control cases in arguing for the disgorgement of the \$4.37 million by the Leach Group over to the Trust Fund. Moreover, the Commission did elaborate quite fully the sale-of-control arguments in its exposition of each of these five principal cases:

(1) *Sugden v. Crossland*.<sup>198</sup> The Vice-Chancellor in 1856 in England was acting in a case of first impression. His rationale was virtually unexplained,<sup>199</sup> but his holding was unimpeachable:

[T]he trustee derived the profit . . . from the [sale of the] office itself. I shall therefore direct that the £75 be re-

196. Brief, *supra* note 30, at 13.

197. *Id.* at 12.

198. 3 Sma. & Giff. 192, 65 Eng. Rep. 620 (V.C. 1856).

199. This, again, could be harsh because the Vice-Chancellor correctly analogizes “trust property” with “the office itself”: “Though there is some peculiarity in the case, there does not seem to be any difference in principle whether the trustee derived the profit by means of the trust property, or from the office itself.” *Sugden v. Crossland*, 3 Sma. & Giff. 192, 194, 65 Eng. Rep. 620, 621 (V.C. 1856), quoted in Brief, *supra* note 30, at 57.

paid by Horsfield and dealt with as part of the assets [of the trust].<sup>200</sup>

The Commission's Brief placed considerable reliance, *passim*, on *Sugden*,<sup>201</sup> and quoted *Sugden* at some length<sup>202</sup> in explanation of the Vice-Chancellor's action "in directing the selling trustee to account to the estate for the funds . . . ."<sup>203</sup>

(2) *McClure v. Law*.<sup>204</sup> The New York courts at the turn of the century made a major contribution to the understanding of the sale of control in general,<sup>205</sup> and this contribution extended to the specific question of the ultimate rationale for the disgorgement of the premium-bribe over to the corporate entity. The *McClure* court was the first to characterize the premium paid for control "as a bribe."<sup>206</sup> More important, *McClure* moved the sale-of-control philosophy from application to a pure trust—as was the case with *Sugden*—to application to a business corporation. Further, the simplicity of a nonstock, nonshareholder entity permitted even the untrained mind to see through to the essentials of sale-of-control premium-bribery.

The Commission used *McClure* to the hilt. Since the facts in *McClure* were on all fours with *Sugden*, no deft fact-finding was required. The Brief concluded effortlessly to the sanction: Disgorgement to the entity, quoting *McClure* appositely:

[*McClure*] held that as president and director he was liable to the corporation

for all moneys that came into his hands by virtue of his official acts . . . . The election of directors, and the transfer of the management and property of the corporation, were official acts, and whatever money he received from such official acts were moneys derived by virtue of his office, for which we think he

200. 3 Sma. & Giff. at 194, 65 Eng. Rep. at 621.

201. "The fiduciary principle [proscribing the "auction" of the "office" of control] . . . was announced by Vice-Chancellor Sir John Stuart one hundred years ago in *Sugden v. Crossland*." Brief, *supra* note 30, at 56.

202. *Id.* at 56-57.

203. *Id.* at 57.

204. 161 N.Y. 78, 55 N.E. 388 (1899), *reversing*, 20 A.D. 459, 47 N.Y.S. 84 (1897).

205. *McClure* was the most prominent New York litigation, but arguably *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163 (1901), was equally prolific of sale-of-control insights. See D. BAYNE, *supra* note 91, at 163-71, 265-78; Bayne, *The Curse of Corporate Control: A Mutual Insurance Company*, 1979 B.Y.U. L. REV. 227, 323-30.

206. 161 N.Y. 78, 80, 55 N.E. 388, 389 (1899).

should account.<sup>207</sup>

Here the Commission, using *McClure*, penetrated to the very foundation for disgorgement to the entity, the illegality of the consideration paid for control. This was one of the three essentials of the illegitimacy of the premium-bribe. Recall the tripartite breakdown:

(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.*<sup>208</sup>

But *McClure*—and hence the Commission—went deeper than the mere statement of the illegality of the consideration, and thereby proffered the correct explanation for disgorgement *to the entity*. Superficial thinking will generally admit to the illegality, but not carry the argumentation to an award to the entity, and thence to the owners of the entity.

The nub of the reasoning lay in the fact that the selection and appointment of a successor contrôleur—whether to a formal trust as in *Sugden*, to a mutual insurance company as in *McClure*, or to a mutual fund as in ISI—“were official acts, and whatever money he received from such official acts were moneys derived by virtue of his office, for which we think he should account.”<sup>209</sup> This concept can be stated more elaborately, but *McClure*<sup>210</sup> and the Commission nonetheless had the basic idea.

In the premium-bribe the incumbent contrôleur accepted [monetary consideration] for a corporate act [the appointment of a successor], the most important of his corporate career, performed “in fulfillment of a corporate duty, in the course of official business, during the regular workweek, for which he was already amply remunerated.”

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207. Brief, *supra* note 30, at 59 (quoting *McClure v. Law*, 161 N.Y. 78, 81, 55 N.E. 388, 389 (1899)).

208. D. BAYNE, *supra* note 91, at 204-05.

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

210. The Brief trod the same ground by using the other turn-of-century New York sale-of-control case, *Bosworth v. Allen*, to the same point. 168 N.Y. 157, 61 N.E. 163 (1901). Thus, the outgoing contrôleurs were liable “even, as we have recently held, for ‘moneys derived by virtue of [their] office.’” Brief, *supra* note 30, at 62 (quoting *McClure v. Law*, 161 N.Y. 78, 81, 55 N.E. 388, 389 (1899)).

. . . [T]he all-important emolument was paid by a third party to a top-level executive as a corporate official because of his official position and was pocketed personally, even though every minute of time and ounce of energy had been dedicated to the exclusive benefit of the beneficiary shareholders.<sup>211</sup>

Immediately following the Brief's resort to *McClure* came the comment that the "same principle was applied in *Moulton v. Field*."<sup>212</sup>

(3) *Moulton v. Field*.<sup>213</sup> Roughly ten years later, the Seventh Circuit, in 1910, brought the federal courts into the tradition. The facts in *Moulton v. Field* were not complicated, hence the law stood out clearly. The Brief selected the correct verbiage to award the premium-bribe over to the corporation:

If the succession was worth \$125,000 in the market, the sale (if it were lawful) should have been made by the directors for the benefit of the owners of the business, not of Gray. For Gray had nothing legally saleable. His contract, being for personal service, was not assignable; and the resolution of the directors really created a new contract with Rosenfeld [the purchaser]. So the arrangement . . . by which the office of general manager and the proxy control were sold to Rosenfeld and the consideration turned over to Gray instead of into the treasury, was a betrayal of trust.<sup>214</sup>

Here is at least an intimation of the same rationale: The appointment of a successor contrôleur was a "personal service."

(4) *Porter v. Healy*.<sup>215</sup> The Pennsylvania Supreme Court, in 1914, provided the Brief with an easily understandable fact situation and a traditional holding:

[H]is official position is not his individual property in any sense, and he has no right, either directly or indirectly, to use it for his own selfish ends; . . . all money thus made belongs either to the corporation, or . . . in common to its shareholders . . .<sup>216</sup>

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211. D. BAYNE, *supra* note 91, at 220-21.

212. Brief, *supra* note 30, at 59.

213. 179 F. 673 (7th Cir. 1910), *cert. denied*, 219 U.S. 586 (1911).

214. Brief, *supra* note 30, at 60 (quoting *Moulton*, 179 F. at 675).

215. 244 Pa. 427, 91 A. 428 (1914).

216. *Id.* at 437, 91 A. at 432.

(5) *Perlman v. Feldmann*.<sup>217</sup> With *Feldmann*, the progress from a strict-trust *Sugden* through nonstock companies such as *McClure* to closely held corporations, *Moulton* and *Porter*, culminates with a widely held stock corporation. *Feldmann* has been analyzed to shreds.<sup>218</sup> But it nonetheless served the Commission well in its argument for disgorgement. The Second Circuit, in 1955, on relatively simple facts, according to the Brief,

remanded the case to the district court for an accounting of that portion of the excess of \$12 per share which reflected the value attached to this managerial prerogative, which, in the court's view, did not belong to the defendants but to the corporation and its shareholders.<sup>219</sup>

Although 'these five principal cases' were selected as worthy of special note here, the Commission, in a brief of 112 pages, relied on other worthwhile opinions. But these five cover the essentials, and are particularly apropos to the disgorgement question.

This question could well be concluded by reviewing the full 20 years and reverting to the testimony of the forties, contained in the 1940 Senate Hearings. Typical of so much of the testimony are the earthy remarks of "Mr. Merrill Griswold, then and for many years later, Chairman of the Board of Massachusetts Investors Trust, the largest of the open-end companies, referring to the evils resulting from the sale of control:"<sup>220</sup>

It has been suggested that the trustees might sell out their office—in other words, that you could come to me and offer me so much money, and that I would resign, and the other trustees would elect, we shall say, Mr. DeRonde to take my place, and then another one of us would resign and we would elect some other man; and in that way we could sell out.

The answer to that is that it is absolutely impossible for us to do that; because under the common law respecting fiduciaries, if we were crooked enough to do it, the funds we would receive would themselves belong to the company, and we could not keep them; and if we did

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217. 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955).

218. But one analysis of *Feldmann* was devoted exclusively to the question under discussion, the triple sanction. Bayne, *The Sale-of-Control Premium: The Disposition*, 57 CALIF. L. REV. 615 (1969).

219. Brief, *supra* note 30, at 63.

220. *Id.* at 76.

keep them, we would be guilty of an embezzlement. In other words, we cannot “sell down the river” if we want to—and we do not want to.<sup>221</sup>

## ii. *Damages*

The apparently uncomplicated question of damages in the sale of control has in fact been the source of considerable confusion. A preliminary distinction will clear the path for undistracted concentration on the narrow area of damages.

### Disgorgement and Damages

The Commission commendably made plain the palpable distinction between (1) the *disgorgement* of the premium-bribe to the corporate entity and (2) the exaction of *damages* from the *outgoing* contrôleur for *later* but foreseeable looting. Here are two totally different wrongs, the former a breach of fiduciary duty founded in strict trust, the latter a simple tort of conversion. No connection—other than common malefactors and victims—exists between the two.

Even in the fact-finding days of 1936-1940, the Commission enunciated this disgorgement/damages dichotomy either through examination of witnesses or in direct statements of the case law.

The succession of an unscrupulous management to control of an investment company was almost immediately followed by a course of dealing between the new management and the company which resulted in a waste and conversion of the corporate assets to the advantage and profit of the new management and to the damage and loss of the public stockholders who were powerless to prevent such activities.<sup>222</sup>

With good insight, the Commission also pointed up a generally neglected presumption that the premium-bribe “was a prime indicator of possible present and future wrongdoing, that such wrongdoing was inevitably a human activity, and that the principal human involved was the incoming contrôleur.”<sup>223</sup>

Nevertheless, although the substantial prices paid to

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221. *Senate Hearings*, *supra* note 1, at 505.

222. *REPORT*, *supra* note 11, at 1024.

223. Bayne, *The Sale-of-Control Quandary*, 51 *CORNELL L. REV.* 49, 70 (1965).



retiring managements for their control should have served to warn them of possible future activities of the purchasers which might be detrimental to the interest of the stockholders, few of the selling management exacted any conditions to their sales which would operate to protect stockholders.<sup>224</sup>

During the examinations of Gerald Beal, a banker who figured in the Continental Securities sell-out (which later reached the courts in the *Reynolds* cases<sup>225</sup>), the Commission again stressed the foreseeability of later looting by a premium-briber:

Q. Well, isn't this a fact, Mr. Beal, and I won't pursue this any further, anybody who will pay you \$20 a share for stock which had . . . a minus \$11 value, . . . when he gets control he can do one thing, that is put his hands on the cash. That . . . is the outrageous way, isn't it?<sup>226</sup>

At another point, the 1938-1940 SEC Report again recurred to the expectable damages subsequent to the sale of control:

Usually, only a cursory investigation of the integrity, responsibility, and ability of the new management was made by retiring managements who had been well compensated for their transfer of control and management.<sup>227</sup>

Predictably, the lessons learned in the thirties led the Commission to stress the danger of future looting in the ISI case. In seeking a reversal of the lower court, the Brief cautioned the Ninth Circuit:

Under the interpretation of the court below, the abuses of the past may recur. Succession to these contracts may once more be put on the auction block for sale to the highest bidder for the benefit of management, and the purchasers may be tempted to pursue hazardous or doubtful policies in order to recoup as quickly as possible the substantial price they paid for stock control and the succession to the agreements.<sup>228</sup>

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224. REPORT, *supra* note 11, at 1089.

225. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 30 N.Y.S.2d 755 (Sup. Ct. 1941); *Ballantine v. Ferretti*, 28 N.Y.S.2d 668 (Sup. Ct. 1941).

226. REPORT, *supra* note 11, at 1087.

227. *Id.* at 1022.

228. Brief, *supra* note 30, at 22.

Later, the Brief stressed the same point:

The new management, forced to pay a substantial premium for control, might take the attitude that it "expected to make it up in management fees . . .," or seek other compensating advantages. In some cases, control was purchased solely for the purpose of looting the acquired company.<sup>229</sup>

The Commission cited both *Reynolds* and *Insuranshares*—the two oft quoted sale-of-control looting cases of the forties—in further support of this obvious distinction between (1) disgorgement of the illegal premium-bribe and (2) damages, only distantly related, for harm later inflicted by the successor contrôleur (the outgoing contrôleur would be liable only on proof of foreseeability).<sup>230</sup>

### Damages and Damages

Understandably, in the early sale-of-control years of the fifties the Commission did not even allude to the very real damages intimately connected with the actual premium-bribery—not distantly related, as with post-sale looting—for which disgorgement is the primary sanction.

Courts have characteristically been unable to comprehend the fact that mere disloyalty, without the slightest subsequent wrong, without any admixture of dollar loss to the trust or dollar gain to the trustee, is a very real injury to the beneficiary.<sup>231</sup>

Thus, irrespective of the *disgorgement* of the illegal consideration, *damages* for the disloyalty of both the incumbent and the successor contrôleurs are very real consequents of the triple malefaction of premium-bribery.

At every conceptual turn, incumbent and appointee faced this obligation in the clear-cut dilemma of a conflict of interest. And thrice each yielded and placed his

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229. *Id.* at 36-37 (quoting *Senate Hearings*, *supra* note 1, at 883, and citing as examples *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940); *Gerdes v. Reynolds*, 28 N.Y.S.2d 622 (Sup. Ct. 1941); REPORT, *supra* note 11, at 98-107).

230. "Recall that, interestingly, only two sale-of-control courts, *Gerdes* and *Bosworth*, have been able to concentrate on both damages and disposition at the same time. All the others were deflected to one or the other." D. BAYNE, *supra* note 91, at 267.

231. *Id.* at 83.

interests before his beneficiary's. Confronted with an avowed objective of successor suitability, each chose an alien consideration, dollars, prestige, personal advantage. The perversion resulted. In giving and taking consideration that belonged to the corporation, each subordinated the corporate benefit to his own. In making and accepting the appointment each foisted a premium-briber on the future of the firm. Yet each had pledged a suitable successor when he assumed the custody. Thus these three breaches coalesced into the single act of disloyalty of a strict trustee.<sup>232</sup>

At one point in the ISI Brief, one might forcibly impute such subtle—subtle? or patent—insights to the Commission. In quoting *Bosworth v. Allen*, did the Commission wish to argue for damages for disloyalty—in contradistinction to damages for later looting, since there was no later looting—in this excerpt?

“[The directors] are liable to account in equity to the corporation or its representatives, not only for the money or property in their hands, but also for such as they fraudulently disposed of or wasted, *as well as for the damages naturally resulting from their official misconduct*; and even, as we have recently held, for money received by virtue of their office.”<sup>233</sup>

This putative point was never pursued, nor did the Commission adduce any other possible support for such disloyalty damages.

### iii. *Dismissal*

The last of the three sanctions can be disposed of with dispatch. The Commission reached the summary conclusion that the successor contrôleur—the Leach Group who premium-bribed their way into control—must be dismissed from office.

[The Commission] sought, *inter alia*, a permanent injunction to restrain the director-defendants from serving as officers and directors of ISI and from serving and acting as directors of the proposed board of directors of the Trust Fund, and ISI from acting as investment adviser

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232. *Id.* at 231.

233. Brief, *supra* note 30, at 62 (quoting *Bosworth v. Allen*, 168 N.Y. 157, 166, 61 N.E. 163, 165 (1901)) (emphasis added).

and principal underwriter of the Trust Fund . . . .<sup>234</sup>

This dismissal was founded on “gross abuse of trust” and mandated by the Investment Company Act:

Its broad and basic purpose is to safeguard the interest of public investors by providing for the removal of officers, directors, investment advisers, principal underwriters and others from their fiduciary and management positions if, in a suit by the Commission, it is shown that they are guilty of “gross misconduct or gross abuse of trust.” So regarded, Section 36, far from being a post-script or statutory aside, performs a vital function in the regulatory scheme of the Act.<sup>235</sup>

This was not a gratuitous conclusion, however. The Commission had, after all, expounded the fundamentals of its long line of argumentation, had embodied them in the equitable philosophy of the Act, and hence could justly conclude that any *contrôleurs* who willingly indulged in such “gross abuse of trust” would be subject to dismissal.

Accordingly . . . they must assume the responsibilities essential to their fiduciary station and the restraints appropriate to their high office. Were a director of a registered investment company to engage in a transaction which involved a sale of his office, he would be subject to removal under Section 36 from any other fiduciary position therein indicated, including that of investment adviser or principal underwriter.<sup>236</sup>

Arguably, no violence would be done to the Commission’s position to impute to the Commission an appreciation of the subtleties—and hence sanctions—of the total turpitude of the premium-bribe, technically defined 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.<sup>237</sup>

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234. *Id.* at 13.

235. *Id.* at 31.

236. *Id.* at 72.

237. D. BAYNE, *supra* note 91, at 257.

Whether complicity in such turpitude is always and everywhere sufficient to warrant ouster is a complex matter for another time.

### III. CONCLUSION: THE COMMISSION FLEES THE FIELD

The rest is anticlimactic. The resounding defeat in *SEC v. Insurance Securities, Inc.* must have sapped all the Commission's energy and will:

We hold that the terms "gross misconduct and gross abuse of trust," as used in § 36 of the act, were not intended to embrace a transaction of the kind described in the amended complaint.<sup>238</sup>

That was 1958. Thenceforward the word for the SEC was 'domitable.'

The outstanding opinion of Judge Friendly, in 1971, in the Second Circuit's *Rosenfeld v. Black*<sup>239</sup> was starkly contra to *Insurance Securities*:

We start from one of the "well-established principles of equity," recognized in *Insurance Securities* itself, . . . "that a personal trustee, corporate officer or director, or other person standing in a fiduciary relationship with another, may not sell or transfer such office for personal gain." There are ample authorities to support this proposition: *Sugden v. Crossland*, . . . (1856); *Gaskell v. Chambers*, . . . (1858); *McClure v. Law*, . . . (1899); *Porter v. Healy*, . . . (1914) . . .<sup>240</sup>

Here was the blessing of the Second Circuit on the very philosophy of the Commission so forcefully espoused over the 20 years, 1936 to 1956.

But even this failed to arouse the enervated Commission.

The nadir was reached in 1975. After decades of dickering—the fine Byzantine hand of the ICI was certainly in evidence—the Commission sent to the Congress an amorphous compromise to the sale-of-control controversy. (The Senate Committee Report employed the oft-used euphemism: "[C]larify the law in light of

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238. *Securities & Exch. Comm'n v. Insurance Sec., Inc.*, 254 F.2d 642, 651 (9th Cir.), cert. denied, 358 U.S. 823 (1958).

239. 445 F.2d 1337 (2d Cir. 1971).

240. *Id.* at 1342.

. . . *Rosenfeld*.”<sup>241</sup> Translate as ‘substantially emasculate.’)

The practical result of the 1975 amendments was a condonation of premium-bribery in the sale of control of investment companies.

An investment adviser . . . may receive any amount  
or benefit in connection with . . . the change in control  
. . . .<sup>242</sup>

Dilation on the minutiae would be otiose. The point now remains: What effect will this ‘open letter’ have on the Securities and Exchange Commission? On the Congress? Or, for that matter, on the legal community in general?

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241. SENATE COMM. ON BANKING, HOUSING & URBAN AFFAIRS, SECURITIES ACT AMENDMENTS OF 1975, S. REP. NO. 75, 94th Cong., 1st Sess. 71 (1975).

242. 15 U.S.C. § 80a-15(f)(1) (1982).

