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I. INTRODUCTION

A derivative suit is brought by a shareholder, in the name of a corporation, to assert a right that belongs to the corporation.[1] Accordingly, if the suit is successful, the corporation will ordinarily recover.[2] There have been, however, a few important cases in which the courts have held that it is the individual shareholders who may recover.[3] The leading case is *Perlman v. Feldmann*,[4] in which the court held that a controlling shareholder could not sell his controlling block of stock at a premium over the market price, and thus ordered that he share the premium pro rata with the rest of the shareholders. *Perlman* prompted an avalanche of commentary addressing the question of whether control belongs to a controlling shareholder or is rather, an asset of the corporation.[5] The remedy of individual recovery,

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1. *See* 13 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5953 (perm. ed. 1984).

2. *See* Keenan v. Eshleman, 23 Del. Ch. 234, 2 A.2d 904 (1938); W. FLETCHER, *supra* note 1, §§ 5953, 6028; Note, *Individual Pro Rata Recovery in Stockholder's Derivative Suits*, 69 HARV. L. REV. 1314 (1956).

3. *See* W. FLETCHER, *supra* note 1, §§ 5953, 6028; W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 904-06 (5th ed. 1980).

4. 219 F.2d 173 (2d Cir. 1955). Professors Cary and Eisenberg, in their classic casebook, cite *Perlman* as the first example of what they call "perhaps the most important category of pro rata cases . . . [namely] the residual category of cases where such relief is the most effective technique for dealing with the parties' varying equities." W. CARY & M. EISENBERG, *supra* note 3, at 905; *see also* W. FLETCHER, *supra* note 1, § 5953.

5. *See* Berle, *"Control" in Corporate Law*, 58 COLUM. L. REV. 1212 (1958); 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); Note, *Liability for Sale of Controlling Stock: Perlman v. Feldmann*, 40 CORNELL L.Q. 786 (1955); Comment, *Corporations—Stockholders—Fiduciary Relationship in Sale of Controlling Stock Interest*, 54 MICH. L. REV. 399 (1956); Comment, *Shareholders' Liability for Sale of Controlling Interest*, 22 U. CHI. L. REV.

however, attracted little significant commentary,[6] despite the fact that the remedy was clearly *wrong* as applied. Although the remedy was concocted as a means of making the nonselling shareholders whole, it is clear upon analysis that it did no such thing. Instead, it allowed the controlling shareholder to realize a significantly higher price for his shares than the nonselling shareholders could obtain, even though the idea behind the remedy was that all shareholders are entitled to equal treatment. Nevertheless, *Perlman* has since been followed by other courts as precedent for pro rata recovery.[7]

The purpose of this article is first, to describe the rationale for individual recovery in sale of control cases and to demonstrate how this rationale was incorrectly interpreted in *Perlman v. Feldmann*. As will be demonstrated, the problem arises because the court incorrectly ordered that the premium be shared pro rata with the nonselling shareholders when it should have ordered—at least according to its own logic—that the *entire* amount of the premium be disgorged by the seller. Second, this article will show that the mistaken holding arose because the court failed to recognize that an out-of-pocket measure of damages, rather than a benefit-of-the-bargain measure of damages, was appropriate. Finally, this article will address whether a benefit-of-the-bargain approach to damages is sensible in sale of control cases, and conclude that ordinarily it is not. In essence, the remedy in *Perlman v. Feldmann* appears to have been incorrect, because

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895 (1955); Recent Cases, *Corporations—Liability of Stockholders—Controlling Stockholder Liable to Minority Stockholder for Profit from Sale of Stock*, 68 HARV. L. REV. 1274 (1955). *See also* Andrews, *Stockholders' Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628 (1965); Deutsch, *Perlman v. Feldmann: A Case Study in Contemporary Corporate Legal History*, 8 U. MICH. J.L. REF. 1 (1974); Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Prof. Andrews*, 32 U. CHI. L. REV. 420 (1965).

6. *See* Grenier, *Prorata Recovery by Shareholders on Corporate Causes of Action as a Means of Achieving Corporate Justice*, 19 WASH. & LEE L. REV. 165 (1962); Note, *Liability of Controlling Stockholders for Profits from Sale of Stock*, 25 FORDHAM L. REV. 137 (1956); Note, *Former Controlling Shareholders Liable for Prorata Share of Difference Between Sale Price and Enterprise Value of Their Shares—Perlman v. Feldman*, 71 HARV. L. REV. 1559; Note, *Shareholders' Derivative and Direct Actions—Individual Recovery*, 35 N.C.L. REV. 279 (1957); Note, *Shareholders' Liability for Sale of Controlling Interest*, 22 U. CHI. L. REV. 895 (1955); Note, *Limitations on the Sale of Controlling Shares*, 1956 U. ILL. L.F. 131; Note, *Shareholders' Right to Direct Recovery in Derivative Suits*, 17 WYO. L.J. 208 (1963).

7. *See* Gabhart v. Gabhart, 267 Ind. 370, 370 N.E.2d 345 (1977) (suit by shareholder of merged company to recover for pre-merger wrong; citing *Perlman*); Atkinson v. Marquart, 112 Ariz. 304, 541 P.2d 556 (1975) (suit by shareholder of dissolved close corporation); *see also* Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R., 417 U.S. 703, 718 n.15 (1974) (suggesting pro rata recovery might be appropriate to avoid recovery by wrongdoers); Rankin v. Frebank Co., 47 Cal. App. 3d 75, 121 Cal. Rptr. 348 (1975) (awarding pro rata recovery in suit involving misappropriation of corporate opportunity). *But see* Bokat v. Getty Oil Co., 262 A.2d 246 (Del. 1970) (pro rata recovery not recognized under Delaware law).

it was either too liberal or too conservative. The implication is that the small but important body of legal doctrine, relating to individual recovery in similar derivative suits, must be seriously questioned.

II. THE REMEDY AND THE RATIONALE

While *Perlman v. Feldmann* is a case of almost mythic standing and raises issues which defy resolution, the facts are quite simple. Feldmann, as controlling shareholder (as well as chairman and president) of Newport Steel Corporation, together with a few friends and relatives, sold their 37% interest in Newport to a consortium of the company's customers for $20 per share at a time when the stock was trading in the open market at $12 per share. Thus, Feldmann sold his shares at a premium of 67% over the market price. The Second Circuit, in one of the few cases to so hold, ruled that Feldmann could not keep this control premium because it represented a corporate opportunity—to allocate scarce steel during wartime—that could not be sold for individual profit at the expense of the remaining shareholders.[8]

8. *Perlman*, 219 F.2d at 177-78. *Perlman* has been followed on this point in a few cases, but certainly has never attained the status of a majority rule. *See* Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 108-12, 460 P.2d 464, 471-74, 81 Cal. Rptr. 592, 599-602 (1969); Brown v. Halbert, 271 Cal. App. 2d 252, 261, 76 Cal. Rptr. 781, 786-87 (1969); *see also* Rowen v. Le Mars Mutual Ins. Co., 282 N.W.2d 639 (Iowa 1979); Comolli v. Comolli, 241 Ga. 471, 246 S.E.2d 278 (1978) (closely held corporation); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975) (closely held corporation). *But see* Rosenfeld v. Black, 445 F.2d 1337 (2d Cir.) (1971), *cert. denied sub nom.* Lazard Freres & Co. v. Rosenfeld, 409 U.S. 802 (1971) (sale of control of investment adviser firm held to be illegal sale of office).

Although the currently active market for corporate control makes the issues in *Perlman* seem quaint, the controversy over who owns control has never really been settled as a matter of law. *See* Davis, *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U.L. REV. 1 (1985); Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982); Hamilton, *Private Sale of Control Transactions: Where We Stand Today*, 36 CASE W. RES. 248 (1985); Hazen, *Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—And A Proposal for Reform*, 125 U. PA. L. REV. 1023 (1977); O'Neal, *Sale of a Controlling Corporate Interest: Bases of Possible Seller Liability*, 38 U. PITT. L. REV. 9 (1976); Ronen, *Sale of Controlling Interest: A Financial Economic Analysis of the Governing Law in the United States and Canada*, 37 CASE W. RES. 1 (1986); Schiff, *Sale of Control: The Equal Opportunity and Foreseeable Harm Theories Under Rule 10b-5*, 32 BUS. LAW. 507 (1977); *see also* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

Indeed one commentator, whose theory it is that the sale of control is equivalent to the sale of a corporate office, has made a virtual career out of the sale of control issue. *See* D. BAYNE, THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY (1986); Bayne, *The Sale-of-Control Premium: The Disposition*, 57 CA-

The action had been brought as a derivative suit in the name of the corporation.[9] Ordinarily, it is the corporation that is entitled to recover in a successful derivative suit.[10] In *Perlman*, however, recovery by the corporation would have represented a windfall to the purchasers.[11] For, as the opinion suggests, the premium may have been paid by the buyer-customers in exchange for the opportunity to buy steel at a lower price by cutting out some of Newport's profit. Moreover, whatever the source of the premium, it represented part of the value of the corporation and could not very well be handed back to the buyers who, after bargaining at arms length, had agreed to pay it. Reasoning that the corporation belonged proportionately to all the shareholders, the court decided to divide the premium proportionately between Feldmann and the remaining shareholders.[12]

As sensible as this result may seem, it is inconsistent with the

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LIF. L. REV. 615 (1969); Bayne, *The Sale-of-Control Quandary*, 51 CORNELL L.Q. 49 (1965); Bayne, *The Sale of Corporate Control*, 33 FORDHAM L. REV. 583 (1965); Bayne, *Corporate Control as a Strict Trustee* 53 GEO. L.J. 543 (1965); Bayne, *The Non-Investment Value of Control Stock*, 45 IND. L.J. 317 (1970); Bayne, *The Investment Value of Control Stock*, 54 MINN. L. REV. 1265 (1970); Bayne, *The Definition of Corporate Control*, 9 ST. LOUIS U.L.J. 445; Bayne, *A Legitimate Transfer of Control: The Weyenberg Shoe—Florsheim Case Study*, 18 STAN. L. REV. 438 (1966); Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963); Bayne, *The S.E.C. and the Sale of Control: Ambivalence, Vacillation or Pusillanimity?*, 33 VILL. L. REV. 49 (1988); *see also* Levmore, *A Primer on the Sales of Corporate Control* (Book Review), 65 TEX. L. REV. 1061 (1987) (reviewing D. BAYNE, THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY (1986)).

9. *Perlman*, 219 F.2d at 174-75. It is not entirely clear why the suit was brought derivatively, but it may have been because the corporate opportunity theory appeared more promising than the idea that the shareholders had a personal interest in the opportunity to sell their stock. Curiously enough, disgruntled shareholders have, in the meantime, succeeded in lawsuits based on the latter theory. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975) (closely held corporation); Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). The issue of whether a shareholder suit in the context of control transaction should be regarded as derivative or direct can be quite difficult to resolve. For example, suppose a target company issues a large block of stock at an attractively low price to a friendly party who agrees to vote with management. A shareholder might challenge such a sale on the grounds that the company received too little for its stock (essentially a derivative mismanagement claim), or on the grounds that the sale thwarted the putative takeover bid or reduced the offered price below what would otherwise have been offered. Such issues appear to arise with increasing frequency. *See* Note, *Distinguishing Individual and Derivative Claims in the Context of Battles for Corporate Control*: Lipton v. News International, PLC 13 DEL. J. CORP. L. 579 (1988). It thus seems quite possible that the issue of individual recovery in derivative suits could arise again in the near future in connection with a sale of controlling shares to a bidder at a premium in excess of that offered to other shareholders. *See* Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988) (discussing possibility that larger shareholders of target companies may be favored with opportunity to sell early and at attractive prices); Freund & Easton, *The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 BUS. LAW. 1679 (1979); Tobin & Maiwurm, *Beachhead Acquisitions: Creating Waves in the Market Place*, 38 BUS. LAW. 419 (1983).

10. *See supra* note 2 and accompanying text.

11. *Perlman*, 219 F.2d at 178.

12. *Id.*

court's reasoning. Simply put, if the premium to Feldmann was a payment for the right to loot the company after control passed (as the court, in effect, held by characterizing the premium as having come at the expense of the remaining shareholders), then the plaintiffs should have been awarded the entire amount. A simplification of the facts is helpful to understand this inconsistency.

Assume that Newport Steel has 100 shares outstanding. Feldmann owns 37 shares and sells them at $20 per share at a time when the market price is $12 per share. The premium may come from two polar sources. The buyer may really think the company is worth $20 per share or the buyer may really think the company is worth $12 per share and have in mind to recoup the premium by selling steel to itself at a smaller mark-up, that is, by later looting the target company. Of course, the price the buyer truly believes to be correct may also be somewhere between $12 and $20, but if it is less than $20, *some* of Feldmann's premium would seem to arise from the opportunity to loot the company.

To complete the calculation, if $12 is the "correct" price, Newport is worth $1200. However, if $20 is the correct price, Newport is worth $2000. The effect of the sale on the remaining shareholders at these extremes can then be calculated as follows:

	$12 per share	$20 per share
Aggregate Value of Company (100 shares);	$ 1200	$ 2000
Less Feldmann Share (37 shares at $20):	740	740
Remaining Value For 63% Outsiders:	$ 460	$ 1260
Value Per Share	460/63 = $ 7.30	1260/63 = $ 20.00
Outsiders' Loss Per Share:	$12.00 − 7.30 = $ 4.70	$20.00 − 20.00 = $ 0.00

In other words, if the shares had truly been worth only $12 each, Feldmann's premium would have been nothing more than a bribe and would have diluted the value remaining for the outsiders dollar for dollar.[13] That is, if $12 is the correct price, it appears that Feldmann has appropriated $4.70 per share of the outsiders' value to himself. If the correct price is $20 on the other hand, Feldmann has appropriated none of the outsiders' wealth. Finally, if the correct price is somewhere between $12 and $20 per share, then Feldmann's premium derives, in part, from both sources.

In *Perlman*, the Second Circuit ordered that the correct value of the stock be determined and that any payment received by Feldmann in excess of that amount be distributed proportionately among the shareholders, that is, 63% to outsiders and 37% to Feldmann and his friends. In the court's view, if the correct value of the stock is $20, there is no award. However, if the correct value is $12, Feldmann has received an excess of $8 per share or an aggregate excess premium of $296. According to the court's order, outsiders should be awarded 63% of the $296. In other words, everyone, including Feldmann, should get $2.96 per share. If, however, the shares were actually worth $12, the outsiders would now have shares worth $6.67 (because of Feldmann's misappropriation) plus $2.96 in cash coming back from Feldmann for each share, or a total of $9.87 per share, *even though their original investment was worth $12.* Feldmann, on the other hand, would have $12 from the sale of the shares at fair value plus $2.96 per share of the premium, for a total of $14.96 in cash. Clearly, something is awry.

The problem is that, according to the logic of the decision, *all* of the excess premium, if any, over the correct value, should have been paid to the outside 63% shareholders. Indeed, this seems to follow almost obviously from the Second Circuit's holding that Feldmann's premium came at the expense of the outside shareholders.[14]

The trial court, on remand, found that the correct value of the shares was $14.67 and accordingly that Feldmann's excess premium amounted to $5.33 per share.[15] Assuming again that there are 100 shares outstanding, the aggregate excess premium for Feldmann's 37 shares would be $197.21. Thus, according to the Second Circuit's order, all shareholders are entitled to $1.97 per share with Feldmann receiving $14.67 plus $1.97 for a total of $16.64 per share. The situation can be depicted as in the previous table:

13. Indeed, the dilution of the outsiders' interest could have easily been greater than dollar for dollar, as it is entirely possible that Feldmann sold control for less than the buyer might have been willing to pay.

14. *Perlman*, 219 F.2d at 177-78.

15. Perlman v. Feldmann, 154 F. Supp. 436, 446 (D. Conn. 1957).

	$14.67 per share
Aggregate Value of Company (100 shares):	$1467
Less Feldmann Share (37 shares at $20):	740
Remaining Value For 63% Outsiders:	$ 727
Value Per Share For Outsiders:	727/63 = $11.54
Outsiders' Loss Per Share:	14.67 − 11.54 = $ 3.13
Add Back Payment From Feldmann:	1.97
Net Loss Per Share After Award:	$ 1.16

In other words, assuming the shares were worth $14.67, as the court found, and assuming as before that Newport had 100 shares outstanding, the company was actually worth $1467, of which Feldmann received $20 per share for his 37 shares or $740, leaving $727 in value for the outsiders or $11.54 per share. Feldmann and the outsiders both received $1.97 per share pursuant to the court's order, leaving Feldmann with $16.64 per share and the remaining 63% of the shareholders with $13.51 per share. Although it appears that everyone ends up better off (at least if one focuses on the fact that the outside shareholders started out with shares that they could only sell for $12), the latter distribution is far from as equal as the court believed it would be.[16]

The conventional wisdom is that the outside shareholders retained their shares which were worth $14.67 and received cash of $1.97 per

16. One cannot help but suspect that on remand the trial court was cast in the role of Solomon and, to a greater or lesser extent, massaged the numbers so that everyone would come out with some gain. For the curious reader, the outside shareholders would have broken even had the stock been valued at $14.96. That is, at $14.96 per share, the portion of the premium disgorged by Feldmann would have fairly compensated the outside shareholders for the supposed loss in value generated by Feldmann's sale.

share for a total value equal to that enjoyed by Feldmann.[17] The reason given by the Second Circuit, however, was that the premium was *at the expense* of the outside shareholders. Moreover, quite apart from this language, it seems clear that the court ruled in favor of the plaintiffs because it concluded that under the circumstances, the premium probably derived from the opportunity to loot Newport later. At the very least, the court must have perceived a significant danger of looting or it presumably would not have ordered any remedy at all. That is, if the premium had arisen because of additional value perceived by the buyers, there would have been no damage to the remaining shareholders. As the court concluded that there was damage to the remaining shareholders, it must have reasoned that the premium arose because of the potential for looting.

III. Reconciling Shareholder Rights and Remedies

Several commentators have noticed the discrepancy between the court's language and its actions.[18] The usual explanation is that the remedy was an effort to compensate the outside shareholders for the opportunity appropriated by Feldmann, while allowing Feldmann to keep a premium for control. It has been suggested that the order in *Perlman* did not require Feldmann to disgorge the full premium but only that portion of it attributable to the corporate opportunity to sell steel during a period of shortage. While there may be some sense in trying to distinguish a control premium from a bribe for a corporate opportunity, the Second Circuit's remedy does not rationally do so. This is apparent from the fact that the more Newport was found to be worth, the less Feldmann was required to disgorge. But clearly, the potential for looting is wholly unrelated to the value of the company (except in the sense that the value of the company is the upper limit of how much can be looted).

Alternatively, however, the court may have confused out-of-pocket damages with benefit-of-the-bargain damages. The award may not have been intended as compensation for the remaining shareholders, but rather as disgorgement of unjust enrichment by Feldmann. This explanation reconciles the apparent contradiction in allowing Feldmann to keep some of the premium for himself. Indeed, one would expect that the more the company is worth, the less the premium

17. *See* Davis, *supra* note 8, at 79 n.270; Hazen, *supra* note 8, at 1030-41; Leech, *supra* note 5, at 809-20; O'Neal, *supra* note 8, at 32-37.

18. *See supra* note 17 and accompanying text. Indeed, the Second Circuit noted that defendants could not well complain about the remedy, as recovery by the corporation would have entailed a larger payment—an observation which should have suggested to the court that the chosen remedy allowed Feldmann to keep something which he would not otherwise have been entitled to but for the form of the remedy. *Perlman*, 219 F.2d at 178.

constitutes unjust enrichment. If *Perlman* was an unjust enrichment case, the unequal distribution is much less troubling since the party that recovers for unjust enrichment need not have been damaged. Redistribution is primarily a way of denying the gain to one party, rather than a way of assuring that the other is made whole.[19]

A major problem with this explanation, however, is that it is inconsistent with the court's looting language.[20] The Second Circuit seems to state that unjust enrichment cannot be the explanation in denying that the decision means a controlling shareholder can never sell control without finding a buyer for all of the shares.[21] Indeed, too active enforcement of notions of unjust enrichment may be counterproductive in the context of resolving the competing claims of shareholders to a piece of the corporate pie.[22] To understand why, it is necessary

19. RESTATEMENT (SECOND) OF RESTITUTION § 1 comments b, g, illustration 7 (Tent. Draft No. 1, 1983).

20. Another serious problem with the holding that Feldmann had been unjustly enriched is that it would have required a substantial departure from the norms of corporation law which are not indicated in the opinion. Any such reading of *Perlman* would seem to imply that Feldmann had a duty not only to manage Newport competently, but also to exploit every attractive opportunity that presented itself, perhaps even irrespective of the line of business. Otherwise every sale of controlling shares at a gain would indeed need to be of all the shares (contrary to what the court said) as it would presumably be occasioned by the buyer's having identified some sort of profitable opportunity that the seller in theory could also have discovered if only he or she had been a better manager. Such a duty has sometimes been argued, but has seldom, if ever prevailed in the absence of circumstances indicating that the company was for sale. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (absent fraud or gross overreaching, the court would not interfere with parent's declining to expand through a subsidiary); Berwald v. Mission Dev. Co., 40 Del. Ch. 509, 185 A.2d 480 (1962) (failing to show fraud or mismanagement minority shareholder not entitled to wind up the corporation); *see also* Joy v. North, 692 F.2d 880 (2d Cir. 1982) (suggesting that corporate fiduciary may have duty not only to seek profit but to seek adequate profit given risk and return characteristics of business), *cert. denied sub nom.* Citytrust v. Joy, 460 U.S. 1051 (1983). *But see* Deutsch, *supra* note 5, at 2 (offering alternative argument that decision was intended as random signal to corporate fiduciaries that mores had deteriorated). *Cf.* Brudney & Chirelstein, *supra* note 8, at 298 (dismissing argument that parent company in parent-subsidiary merger is entitled to larger share of gain if parent happens to be in business of acquiring companies for profit); Hayes & Abernathy, *Managing Our Way to Economic Decline*, HARV. BUS. REV., July-Aug. 1980, at 68 (questioning whether financial strategies can be applied to operations); Note, *The Conflict Between Managers and Shareholders in Diversifying Acquisitions: A Portfolio Approach*, 88 YALE L. J. 1238 (1979).

21. *Perlman*, 219 F.2d at 178.

22. The courts have only recently begun to experiment with the use of a benefit-of-the-bargain measure of damages in corporate control cases. The tendency in Delaware is to use such a measure as a sort of penalty when there is a breach of fair dealing between fiduciary and minority shareholder, but nevertheless to recognize that the fiduciary is entitled to keep to itself its own opinions based on its proprietary knowledge of the value of the minority interest in question and likewise to keep the gain in a

to consider the reasons why buyers of whole companies are willing to pay a premium over market price and why owners of control can legitimately claim a right to this peculiar good.

IV. UNJUST ENRICHMENT AND THE SOURCES OF PREMIUMS

The ultimate question presented by *Perlman v. Feldmann* is why was the buyer willing to pay a premium? Outright looting, or looting consisting of the right to allocate to oneself scarce steel during wartime price controls, seems to be a genuine possibility and appears to be the explanation that the court found most likely. And it is hardly exonerating that the premium was exacted from a third party after arms length bargaining if the premium is in exchange for the right to loot the company later. (Feldmann, after all, should not be allowed to do indirectly what he cannot do directly.) While it might be argued that courts can deal with looting after a sale of control if and when they find it, if later looting is the *only* believable way a buyer can make back a premium, then it would seem better to recognize an action against the seller while the seller still has the cash.[23] In short, the holding, though not the remedy, is at least defensible. There are,

fairly made bargain. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985); Joseph v. Shell Oil Co., 482 A.2d 335 (Del. Ch. 1984); Weinberger v. UOP, Inc., 457 A.2d 701, 712-14 (Del. 1983); Lynch v. Vickers Energy Corp., 429 A.2d 497, 505 (Del. 1981). The federal courts, on the other hand, have been extremely reluctant to award benefit of the bargain damages in any but the most egregious cases of fraud involving clearly gain-based inducements to trade. *See* Osofsky v. Zipf, 645 F.2d 107, 114 (2d Cir. 1981). *See generally* Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 VAND. L. REV. 349 (1984).

Similarly, most states interpret the statutory appraisal remedy for shareholders dissenting from mergers and other fundamental changes to allow only for an out-of-pocket measure of compensation, that is, the value of the stock on the day before the merger (or other transaction) and exclusive of any gain or loss from the transaction itself. *See* Armstrong v. Marathon Oil Co., 32 Ohio St. 3d 397, 513 N.E.2d 776 (1987). In other words, appraisal cannot compensate a dissenting shareholder for any gain that should have been realized or shared even if it is clear that it would have been bargained for in a fair negotiation. Delaware has admirably cast off this Neanderthal notion. *See Weinberger*, 457 A.2d at 712-14.

23. In other words, the appropriate remedy would seem to be the imposition of a constructive trust on the proceeds. *See, e.g.*, Lynch v. Vickers Energy Corp., 429 A.2d 497 (Del. 1981); Klinicki v. Lundgren, 298 Ore. 662, 683, 695 P.2d 906, 920 (1985); Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503, 510 (1939); *see also* Snepp v. United States, 444 U.S. 507, 515 (1980). Even in cases in which the benefit is conveyed to a third party, the courts will often impose a constructive trust if it is apparent that the benefit could only have arisen as a result of a breach of a fiduciary duty about which the third party should have known. *See* Fry v. Trump, 681 F. Supp. 252 (D.N.J. 1988) (recognizing cause of action for aiding and abetting breach of fiduciary duty in connection with greenmail payment); Heckmann v. Ahmanson, 168 Cal. App. 3d 119, 135, 214 Cal. Rptr. 177, 188 (1985) (constructive trust imposed on proceeds of greenmail payment found likely to be in breach of fiduciary duty); Gilbert v. El Paso Co., 490 A.2d 1050 (Del. Ch. 1984) (recognition of possible cause of action for conspiracy to breach fiduciary duty); *see also* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1 (1985)

however, other possible reasons why the buyer may have been willing to pay a premium.

A. *Misappropriation of Corporate Opportunity*

First, the premium could have come from the buyer's willingness to pay a *higher* price for steel. Due to wartime price controls, Feldmann could not charge higher prices (though the "Feldmann Plan" he devised to obtain interest-free financing from customers amounted to just that).[24] That is, Feldmann could not pass on the benefit of higher prices to shareholders in the normal way. Assuming Feldmann could show that he had not found a buyer for more than 37% of the shares, it would seem that he could argue he was merely taking advantage of an indivisible benefit—one that by its nature could not be shared—and had done no harm to the shareholders, though he had clearly enriched himself.[25] The intriguing aspect of this possibility is that it suggests that premiums may be appropriate in unusual times, but inappropriate in ordinary times, which is exactly the opposite of what the court in *Perlman v. Feldmann* said.[26] Nevertheless,

(successful bidder for target paid most of settlement where it appeared hard bargaining may have led to breach of fiduciary duty on part of target board).

The case for a constructive trust against a fiduciary himself, such as Feldmann, should be even stronger. But, again, the remedy only fits if there is no other reasonable explanation for the transaction in question. *See* Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592, (1969) (use of holding company to facilitate trading of interests in subsidiary denied access of remaining subsidiary shareholders to market for no good reason and had potential for almost total separation of financial claims from control). A per se rule, after all, would effectively prohibit a customer's buying a controlling interest in a supplier (or vice versa). Presumably such transactions are sometimes wealth enhancing. *See* Levmore, *A Primer on the Sales of Corporate Control* (Book Review), 65 TEX. L. REV. 1061 (1987) (reviewing D. BAYNE, THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY (1986)). Thus, the courts have, at most, generally required only that there be a business purpose for corporate control transactions. *See* Singer v. Magnavox Co., 380 A.2d 969, 979 (Del. 1977) (procedural approach which eschews any review of motivations); Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964); *see also* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983) (overruling *Singer* business purpose test); Note, *Approval of Take-out Mergers by Minority Shareholders: From Substantive to Procedural Fairness*, 93 YALE L. J. 1113 (1984). (It bears noting that *Perlman* can be seen as quite similar to *Cheff* in that the court may have compensated for potential looting by the buyer in *Perlman*, whereas the board of directors prevented looting by a potential buyer in *Cheff*.).

24. Perlman v. Feldmann, 219 F.2d 173, 177-78 (2d Cir. 1955).

25. In fact, there had been negotiations between Newport and Follansbee Steel Corp. regarding a possible merger, but Feldmann rejected the offer just days before he sold his stock. *See* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 462 (2d Cir. 1952).

26. It might be argued that the Feldmann Plan amounted to a way of exacting higher profits despite price controls and that the sale of Newport to its customers

courts have generally taken a dim view of the argument that a corporation is not in a position to exploit an opportunity for the benefit of all of its shareholders and have placed a high burden on managers and controlling shareholders to prove that the opportunity in question could not be shared.[27]

B. The Prospect of Superior Management by the Bidder

A second possible reason why the buyer may have been willing to pay a premium is because the buyer thought it could manage the company more efficiently. Alternatively, the buyer may have had secret plans for the company or there may have been some unusual synergy between the company and another company owned by the buyer. In such a case, Feldmann would naturally bargain for part of the gain even if he did not know why the buyer believed the company was valuable. Feldmann would reason that the buyer would not be buying but for an expected gain, therefore, Feldmann would insist on part of the gain.[28] This possiblility, however, would seem to raise the same question as the indivisible benefit scenario: Is there any justification for denying some of the bonus to the other shareholders? If the premium comes from the third party buyer's innovative ideas, why should Feldmann be allowed to keep a disproportionate share of the gain? Such a bonus is pure windfall and in no way oper-

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might result in their ending whatever Feldmann Plan contributions they had been making. There are two responses. First, if the Feldmann Plan contributions were indeed a valuable substitute for conventionally measured profits they would have been (or indeed were) reflected in the $12 price of the stock. Second, if the customers neglected to continue the contributions, which had become something of an industry standard, presumably they would be guilty of looting.

27. *See* Irving Trust Co. v. Deutsch, 73 F.2d 121, 124 (2d Cir. 1934)(defense of rejection of opportunity questioned since directors might have less incentive to seek financing or to take other steps to exploit if opportunity can be appropriated); Klinicki v. Lundgren, 298 Ore. 662, 676-81, 695 P.2d 906 (1985) (argument that opportunity would have been rejected or could not have been exploited will not be heard unless opportunity has been offered); Note, *Corporate Opportunity*, 74 HARV. L. REV. 765 (1961). This is much more in keeping, of course, with the traditional notions of fiduciary duty which viewed conflict of interest as per se illegal (and immoral) rather than as a conflict of legitimate competing interests; *see, e.g.*, Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928); N. LATTIN, CORPORATIONS 565 (1965); *see also* Levmore, *A Primer on the Sales of Corporate Control* (Book Review), 65 TEX. L. REV. 1061 (1987) (reviewing D. BAYNE, THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY) (1986)) (suggesting that decision in *Perlman* might have been prompted by fact that Feldmann's sale at premium was a roundabout way of avoiding price controls and thus prompted more by outrage at wartime venality). *Cf.* Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887-88 (Del. 1970) (subsidiary's loss of oil import quota because of acquistion of control by parent not compensable since parent gained nothing by virtue of loss); Meyerson v. El Paso Nat. Gas Co., 246 A.2d 789, 794 (Del. Ch. 1967) (same, benefit of subsidiary's tax losses); Coffee, *supra* note 25, at 4 (suggesting need to regulate shareholder pressure on management to appropriate wealth of senior constituent groups).

28. *See generally* Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153 (1986).

ates to encourage Feldmann himself to innovate (except perhaps in looking for buyers). The fact remains, however, that no one seems to be harmed. The courts have generally held in this situation that it is perfectly legitimate for the controlling shareholder to keep the premium. The apparent reason is that it seems desirable to allow sales of large partial interests in companies rather than to require that all sales of control be accompanied by an offer to all the shareholders to sell out.[29] Any requirement that all shareholders be given an equal opportunity to purchase shares would presumably eliminate smaller buyers from the competition for control, as these smaller buyers would find it difficult, or even impossible, to put together the financing necessary to acquire of all the shares.[30] Moreover, if the sale is motivated by the bidder's better ideas, the nonselling shareholders who are left behind will share in the gains as shareholders. It thus seems clear that in a case involving a sale motivated by the bidder's better management, the burden should be on the shareholder who challenges the sale of control, and the judicial distinction between such a case and an indivisible benefit case—where the burden rests with the controlling shareholder—is well taken, for it permits and even encourages transactions which increase overall wealth while prohibiting transactions which merely rearrange wealth.

C. *The Possibility of Differing Opinions as to Value*

A third possible justification for the premium is that Feldmann believed his company was worth more than the market price indicated or, at the very least, that it was worth more to him than to the other shareholders. The question is thus whether Feldmann could legitimately believe that the price he demanded and received was compensation for what he gave up and not because he was in a position to loot the company or sell the right to loot the company. The arguable problem with this justification is that while it is possible that an outsider may have a differing opinion about the value of a company

29. It bears noting that such is the rule in the United Kingdom. *See* DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U. L. REV. 945 (1983). The idea has been rejected in the United States except in isolated judicial decisions. *See supra* note 9 and accompanying text. Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Action, Exchange Act Release No. 21079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,637, at 86,914, 86,917-18 (June 21, 1984).

30. On the other hand, with the ready availability of junk bond financing, there may be few remaining obstacles for smaller bidders. *See* Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986).

due to some secret plan, an insider is arguably duty-bound to use any such idea for the good of all the shareholders. Feldmann's belief that Newport was truly worth $20 per share, even if genuinely held, ought to hold for the minority shares as well. If it does not, then either the idea did not exist and Feldmann was getting a payment in consideration of the buyer's later looting of the company or, Feldmann was in effect receiving a bribe not to put his plan into action.[31]

This argument is based on the assumption that there is one best estimate of the value of a company under incumbent management. On the one hand this does not seem like an extreme assumption. After all, the concept of the efficient market is now well established (although it was not in 1955). It has thus been suggested by commentators of widely differing philosophical leanings, that claims by managers that the company is undervalued (and is therefore an appropriate candidate to be taken private through a management buyout) or that the company is actually worth more than some suitor is offering (and therefore a tender offer must be resisted), are simply incredible.[32] Despite these protestations, however, management buyouts, and tender offer defenses, remain prevalent. Their continued existence suggests that shareholders do not, on balance, find such tactics objectionable[33] and that there is something fallacious about the assumption that there is one correct price for a company. Indeed, it is the idea that a company cannot be worth more to a bidder (or management for that matter), even in the absence of plans to loot it later, that ultimately does not withstand analysis.

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31. One might even go so far as to presume that a big bonus for control without a concomitant rise in the price of publicly held stock signals an intent on the buyer's part to later loot the company. . . or at least that remaining shareholders expect the buyer later to loot the company. *See generally* Booth, *The Emerging Conflict Between Federal Securities Law and State Corporation Law*, 12 J. CORP. L. 73 (1986) (describing dynamics by which shareholder opinions are reflected in market prices); Dennis, *Materiality and the Efficient Capital Market Model: A recipe for the Total Mix*, 25 WM & MARY L. REV. 373 (1984) (same); Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW 1 (1982) (same). On the other hand, as is discussed more fully below, there are any number of reasons why market prices may not reflect values perceived by purchases of control.

32. *See* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). It bears noting, though, that some of the same commentators have also argued that any peculiar regulation of sales of control at a premium will impede the transfer of corporate assets to their highest valuing owner and will thus be inefficient. *Compare* Easterbrook & Fischel, *supra*, *with* Easterbrook & Fischel, *supra* note 8. For an example of a recent and regretable decision that the pre-bid market price is presumed to be fair compensation to a dissenting shareholder if there was an active market for the target stock, see Armstrong v. Marathon Oil Co., 32 Ohio St. 3d 397, 513 N.E.2d 776 (1987).

33. *See generally* Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807 (1987); Leebron, *supra* note 23, at 157.

1. Downward Sloping Demand

Consider some simple facts about stock. For example, it is well established that the more shares one seeks in a tender offer, the more one must pay per share to obtain them.[34] This observation, together with the fact that a company's repurchasing of its shares has a tendency to raise or "stabilize" the market price[35] and the fact that large offerings of shares have a tendency to lower the market price,[36] strongly suggest that shareholders have differing opinions as to the worth of the shares. These rather simple facts answer both the *Perlman* court and those who would argue that any premium at all ought to be enough to induce a shareholder to tender. In short, it is at least believable that some shareholders value their shares more highly than others and should be entitled to keep what appears to be an unusually high price from their sale. Moreover, such a belief has no untoward implications for one who subscribes to the efficient market theory: An efficient equilibrium can be reached by the interaction of traders at any level of shareholder demand and one would fully expect the equilibrium price to differ depending upon the supply. In short, the assumption that any premium paid to the seller over the true value must come out of the pockets of the remaining shareholders is dubious at best.[37]

34. *See* S.E.C. Office of the Chief Economist, *The Economics of Any-or-All, Partial and Two-Tier Tender Offers* (Apr. 19, 1985).

35. *See* Dann, *Common Stock Repurchases: An Analysis of Returns to Bondholders and Stockholders*, 9 J. FIN. ECON. 113 (1981). *But see* R. CLARK, CORPORATE LAW § 14.4 (1986).

36. *See* Dann, Meyers, & Rabb, *Trading Rules, Large Blocks, and the Speed of Adjustment*, 4 J. FIN. ECON. 3 (1977); Kraus & Stoll, *Price Impacts of Block Trading on the New York Stock Exchange*, 27 J. FIN. 569 (1972); Scholes, *The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices*, 45 J. BUS. 179 (1972).

37. The possibility and implications of downward sloping shareholder demand for stock has been considered in several other works. *See* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1719-20 (1985); Booth, *The Problem with Federal Tender Offer Law*, 77 CALIF. L. REV. __ (1989); Booth, *Management Buyouts, Shareholder Welfare, and the Limits of Fiduciary Duty*, 60 N.Y.U. L. REV. 630, 633-38 (1985); Carney, *Fundamental Corporate Changes, Minority Shareholders and Business Purposes*, 1980 AM. BAR FOUND. RES. J. 69, 112-18; Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1178-83 (1984); Kanda & Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429 (1985); Levmore, *Efficient Markets and Puzzling Intermediaries*, 70 VA. L. REV. 645, 653-54 & n.29 (1984); *see also* A.L.I., PRINCIPLES OF CORPORATE GOVERNANACE: ANALYSIS AND RECOMMENDATIONS § 5.02(a)(1) comment, at 30-31 (Tent. Draft No. 5 1986) ("fairness is often a range rather than a point"); Chazen, *Fair-*

2. Risk and Monitoring

Even if one is reluctant to embrace the notion that shareholders may hold genuinely different opinions as to the value of the same shares (though the idea is perfectly well accepted with respect to every other sort of scarce good), there are other reasons to believe that good faith disagreements as to value will arise and may ultimately be reflected in discrepant prices being paid for various shareholders' shares. In the first place, the owner of control is privileged, within the broad limits of due care, to run the company as he sees fit.[38] This clearly creates some additional risk for noncontrolling shareholders who may prefer policies other than those that management ultimately chooses to pursue. The controlling shareholder faces less risk because there is no chance that management will make a disagreeable decision. Less risk means that, other things being equal, the same investment is worth more.[39] In short, a controlling shareholder's shares are, by definition, worth more than a noncontrolling shareholder's shares. To put the matter starkly, some level of looting (or what might better be called "quasi-looting") is to be expected and tolerated. No one would buy control of a company unless control was worth something over and above the value of the shares themselves as passive financial claims on the wealth of the company. Yet, by definition, any such excess is denied to the remaining shareholders.

To some extent, this reasoning applies to all large shareholders who are in a position to affect the company's policies. The fewer shares one owns, the less there is to be gained by keeping a close watch on management behavior, as most of the benefits of monitoring will be captured by others who own more shares. However, the larger shareholder, who understands that monitoring efforts benefit other shareholders as well, will rightfully seek to recapture part of that benefit possibly by obtaining favored treatment from the company. Monitors, after all, deserve to be paid like any other provider of services.[40] Even if a monitor does not seek to be paid specially, the

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ness from a Fincancial Point of View: Is "Third Party Sale Value" the Appropriate Standard?, 36 BUS. LAW. 1439 (1981).

38. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971).

39. *See* W. KLEIN & J. COFFEE, BUSINESS ORGANIZATION AND FINANCE 145-67 (3d ed. 1988).

40. *See generally* Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49 (1982). It bears noting, however, that vote selling is universally condemned when it is not accompanied by a sale of the financial rights in the corporation probably because differing distributions of votes and financial participation are seen to create incentives to use control in ways other than to increase the value of the firm as a whole. *See* Easterbrook & Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 410-11 (1983). On the other hand, allowing control to be sold without all shares being sold can be viewed as inviting the same problem, but it is nevertheless permitted not only in the sale of control context but in much subtler ways such as al-

controlling shareholder will likely make a point of seeking to please any shareholder who is in a position to monitor. Thus, to some extent, unequal division of corporate benefits is justified as a means of keeping management more honest than it otherwise would be and controlling blocks of stock, which carry such prerequisites, tend to sell for more than smaller blocks.[41]

3. Diversification

Finally, the most important reason that shareholder opinions as to value can differ is that some shareholders are more diversified than others.[42] While there is no excuse for a purely passive investor to fail to diversify, such is not the case with controlling shareholders. There are two fundamentally different reasons for investors to invest. One is for passive financial return. The other is for financial return in connection with active management. The former type of shareholder, operating in an efficient market, is a rational price-taker who wastes time and money trying to outguess the market. This is so, not only because the market cannot consistently be beaten, but because with a diversified portfolio of investments, selected on the basis of offsetting risks rather than on predictions as to which companies will perform best, the investor can minimize overall risk. The manager-investor, however, is *vitally* interested in the fortunes of the subject company precisely because he or she is actively involved in managing it. Moreover, the manager-investor *cannot* diversify in crucial ways. Aside from the fact that one would need to be incredibly wealthy to form a balanced diversified portfolio, much of a manager's investment is in the form of human capital, that is, knowledge, skills, contacts and other intangibles. These are of value only in con-

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lowing dual class capitalization structures. *See, e.g.*, Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969) (use of holding company to facilitate trading of interests in subsidiary denied access of remaining subsidiary shareholders to market for no good reason and had potential for almost total separation of financial claims from control); Clark, *Vote Buying and Corporate Law*, 29 CASE W. RES. 776 (1979).

41. In addition to the now quite standard agency cost explanation for takeover premiums, other explanations have recently been offered. *See* Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597 (1989); Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891 (1988). It has also been suggested that tax savings from substituting debt for equity may account for takeover premiums. *See, e.g.*, Lowenstein. *Management Boyouts*, 85 COLUM. L. REV. 730 (1985). On reflection, this seems unlikely since it would be just as easy (indeed easier) for incumbent management borrow and make a large one-time distribution to shareholders.

42. *See generally* Coffee, *supra* note 30, at 4.

nection with this or possibly a few other enterprises. In addition, the manager may have agreed, precisely for the passive shareholders' benefit, to forgo current compensation as a way of bonding performance. Thus, the manager will accumulate a still greater undiversified investment in the form of deferred compensation. The inability of managers to diversify suggests that their investments are, dollar for dollar, less valuable than diversified investors' investments. This may suggest that a controlling shareholder's receipt of a premium is even more offensive than it might at first appear. On reflection, however, this is clearly not the explantion, for no one would invest in control if it were more profitable to diversify. It must be that controlling shareholders tend to value their companies *much* more highly than do passive investors as the value seen in the company must compensate the controlling shareholder for the additional risk taken by forgoing diversification.

Although one may be inclined to suspect that a sale of control at a premium is likely to be motivated by the buyer's desire to loot the company—especially when the buyer is a customer as in *Perlman*—there are subtle but powerful reasons why shareholders can differ in their opinion as to the value of the same company. This is so even when one does not consider the traditional notions that directors, officers and controlling shareholders are trustees (of sorts) for the shareholders, and should be required to account for any gain realized in dealing with the company. Today, very large premiums are paid for such control even when there is no real likelihood of looting. Nevertheless, there are a significant number of deals, such as management buyouts, in which conflicts of interest inhere. The fact that shareholders have not generally pressed for the prohibition of such deals strongly suggests that they represent a gain for both parties.

V. The Remedy Revisited

While in the end it seems most likely that the Second Circuit saw *Perlman v. Feldmann* as a looting case, the single price fallacy clearly infected the remedy regardless of theory behind it. The appeals court remanded the matter to the trial court to determine the value of the company, presumably prior to the sale of control, in order to determine the excess, if any, Feldmann had received. Yet, the only way to determine whether Feldmann had received an excess would have been to figure the company's worth under management by the buyers after the sale. That, of course, is difficult to do, if for no other reason than that buyers are often reluctant to discuss their plans for a company for fear of tipping off competitors.[43] Nevertheless, it seems quite evident that a seller and a buyer *must* have differing opinions as to the value of anything they trade. Indeed, in the absence of opportunity to loot, the *only* reason one sells anything is that the buyer perceives it to be worth more than the selling price.[44] It is entirely believable that Feldmann himself placed a higher value on his stock than did most outside shareholders, simply because he was privileged enough to control the company.

In light of the foregoing, it is clear that the remedy of pro rata recovery of the control premium makes no sense in *Perlman v. Feldmann.* If the case is a looting case, the entire premium over the putative fair value of the stock should be paid to the outside shareholders. If the case is not a looting case, there is no damage to the outside shareholders while there are very good reasons—unanswered by the the Second Circuit's opinion—why a controlling shareholder might legitimately bargain for a premium in connection with a sale of control.

It is of course possible that the premium came in part from both sources. That is, Feldmann may have figured that his stock was worth about $15 a share and may have been pleasantly surprised that the buyers were willing to pay $20. In all fairness, the court may have thought that it was doing rough justice by allowing Feldmann to cash out at a fair price and requiring only that the excess premium be shared. The problem with such a charitable view of the remedy is that the outside shareholders are almost certainly *over-compensated.* The premise, after all, is that their shares are worth more than the

43. *See* Easterbrook & Fischel, *supra* note 32, at 1165 (arguing that defensive tactics are economically inefficient because they discourage first bidders from making the initial investment in searching for a target and putting together a deal some of which costs can be avoided by subsequent bidders freeriding on the first bidder's discovery). For an example of a case in which the potential purchaser insisted on a leg up, apparently, in part, to act as compensation in the event his bid failed, see Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). *See also supra* note 28, and accompanying text.

On the other hand, there was evidence that Feldmann had declined an earlier offer for Newport that would likely have allowed all the shareholders to sell. *See* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 462 (2d Cir. 1952). If indeed Newport was for sale all along, it is not so clear that *Perlman* is a decision very far out of the mainstream of current law. It is fairly well-settled at this point that once a company is for sale, the board of directors has a strict duty to seek the highest price for all the shareholders and to eschew personal benefits. *See* Hanson Trust, PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986); Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275 (1989).

44. *See generally* Leebron, *supra* note 28, at 159.

market price indicated, but the remedy allows them both to keep their shares and receive part of the payment for which Feldmann bargained.

Ironically, then, it seems irrefutable that the remedy of pro rata individual recovery in a sale of control case is either too little or too much from the outside shareholders' point of view. There is no scenario in which pro rata recovery appears to make any real sense, yet individual recovery in a derivative suit is invariably pro rata. The inescapable conclusion is that either the remedy is wrong or derivative suits are inappropriate in sale of control cases. Either way, the entire body of law that has descended from the remedy devised in *Perlman v. Feldmann* must be questioned.

VI. Conclusion

If the Second Circuit is to be taken at its word, *Perlman v. Feldmann* must be viewed as a looting or potential looting case. If it is a looting case, and not an experiment with an expanded rule of equal treatment for shareholders, the remedy of proportional individual recovery of the premium paid to Feldmann was clearly wrong. If it was not a looting case, the remedy is even more clearly wrong as there are any number of reasons why controlling shareholders might legitimately seek a premium for their shares. It thus seems unlikely that there is any situation in which pro rata individual recovery is appropriate in a sale of control case.