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## THE PRICE OF POWER: SALE OF CORPORATE CONTROL

*Adolf A. Berle†*

Sixteen years ago, Dean Stevens prefaced the second edition of his classic Handbook on the Law of Private Corporations with a remark:

There is apparent, however, a slowly developing tendency in case law to recognize and enforce the fiduciary obligation of those in control of corporate affairs toward the whole body of security holders and each class thereof.<sup>1</sup>

He accordingly added a chapter, not found in the first edition, on "Authority and Responsibility of Those Exercising Voting Control," and stated a general rule:

A shareholder is not disqualified from voting merely because he has a personal interest in the transaction to be voted upon. But those who hold control of the corporation owe a duty to exercise their power for the benefit of the corporate group as a whole and not for their own interests solely.<sup>2</sup>

He considered the rationale of the rule to be that the "scheme" of corporate management under which a majority of shareholders is vested with power to make corporate decisions carried with it the obligation that this power must be exercised as a whole.<sup>3</sup> The ensuing sixteen years produced a notable series of cases applying this principle. Included among them are a number of decisions relating to the right of those holding control interest to sell the stock carrying such control at a price reflecting or including a premium over market precisely because it carried control power with it.

This application of Stevens' doctrine reaches deep into the central nervous system of corporate organization. That fact, as well as the commercial interest involved, has, I think, been the cause of elaborate academic writing on the subject.<sup>4</sup> Some of the writing and cases take off from an observation I made in 1932. At that time, the dominant stockholders in the Loew theatre chain arranged to sell their stock to interests

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<sup>1</sup> Stevens, *Corporations* at vii (2d ed. 1949).

<sup>2</sup> *Id.* § 126, at 567.

<sup>3</sup> *Id.* § 126, at 568.

<sup>4</sup> See Bayne, "Corporate Control as a Strict Trustee," 53 *Geo. L.J.* 543 (1965); Bayne, "A Philosophy of Corporate Control," 112 *U. Pa. L. Rev.* 22 (1963); Bayne, "The Sale of Corporate Control," 33 *Fordham L. Rev.* 583 (1965); 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); Katz, "The Sale of Corporate Control," 38 *Chi. B. Rec.* 376 (1957); Leech, "Transactions in Corporate Control," 104 *U. Pa. L. Rev.* 725 (1956); Comment, "Sales of Corporate Control and the Theory of Overkill," 31 *U. Chi. L. Rev.* 725 (1964).

dominated by the late Mr. William Fox, and were paid nearly double the current market price for their shares. A minority stockholder sued to compel the Loew interests to pay over to the corporation the premium over market which they had received for their stock, and on motion to dismiss the trial court upheld the complaint.<sup>5</sup> I argued that "the power going with 'control' is an asset which belongs only to the corporation; and that payment for that power, if it goes anywhere, must go into the corporate treasury."<sup>6</sup> It was apparent that the value of control "arises out of the ability which the holder has to dominate property which in equity belongs to others,"<sup>7</sup> and that the law had thus far been unable to deal with the situation. The rationale behind the reasoning is the same as that adopted by Dean Stevens in his statement of the rule.

Some risk is involved in adding to the spate of legal literature dealing with the subject. It has been discussed and rediscussed. Professor W. D. Andrews is the latest to enter the field.<sup>8</sup> He accepts the proposition—as have most courts—that an individual or group selling stock carrying control of a corporation and receiving a premium over market for that stock will be required to account to the other stockholders for the premium unless the other stockholders have been offered opportunity to sell their holdings, in whole or pro rata with the control sellers, at an equal price. He dismisses the theory that power is a corporate asset and that therefore the premium belongs to the corporation. He erects a rule that:

[W]henever a controlling stockholder sells his shares, every other holder of shares (of the same class) is entitled to have an equal opportunity to sell his shares or a prorata part of them on substantially the same terms. Or in terms of the correlative duty: before a controlling stockholder may sell his shares to an outsider he must assure his fellow stockholders an equal opportunity to sell their shares, or as high a proportion of theirs as he ultimately sells of his own.<sup>9</sup>

As he sees it, the power over the corporation implied in the stockholder's vote is an element of value corresponding to each share of such stock; consequently such share is entitled to a pro rata proportion of that element of value whenever control is transferred at a price over market. The rule is, of course, novel; but that is not an objection. The purpose of this essay is to analyze briefly the rationale of various approaches to the problem of the sale of control. Specifically, our problem is to discover

<sup>5</sup> *Stanton v. Schenck*, 142 Misc. 406, 252 N.Y. Supp. 172 (Sup. Ct. N.Y. County 1931).

<sup>6</sup> *Berle & Means, The Modern Corporation and Private Property* 244 (1933).

<sup>7</sup> *Ibid.*

<sup>8</sup> Andrews, "The Stockholder's Right to Equal Opportunity in the Sale of Shares," 78 *Harv. L. Rev.* 505 (1965); see Javaras, "Equal Opportunity in the Sale of Controlling Shares: A Reply To Professor Andrews," 32 *U. Chi. L. Rev.* 420 (1965).

<sup>9</sup> Andrews, *supra* note 8, at 515-16.

the fundamental rule itself, and to suggest that courts may have at their disposition various remedies. Seen in that light, Professor Andrews' analysis emerges not as a change in theory, but as a suggestion of one of a number of possible remedies.

## I

### POWER AND CONTROL

The essence of control—a loosely used word—is power to choose the directors and management of a corporation. Such power is not necessarily bound to stock. Let us note its four variants:

(1) The controlling interests may hold fifty-one per cent of all voting stock. No question here: the voting power of the stock carries with it control.

(2) Control may be exercised by an individual or group holding less than a majority of the stock, but a large minority block, the majority being scattered. Such a block can ordinarily attract to itself enough additional votes to dominate a corporate election.<sup>10</sup> The power goes not merely with the votes of the minority block of stock but also depends on the capacity of the control holder to add in the necessary complement.

(3) Control may be vested in a relatively small minority block of stock plus a relationship of its holders to the board of directors. The directors acting in accordance with the wishes of the control holder will designate a "management slate" of directors at each annual election as the control holder directs. Where stock is widely distributed, the normal inertia of shareholders leads them to vote the "inmanagement slate" as a matter of course. Such control is vulnerable to a proxy fight; but the organization of an opposition slate, campaign, and proxy fight is expensive and occurs rarely. This is frequently called "working control." Power to choose directors and management here is lodged only partly in the stockholdings of the minority, but chiefly in a diplomatic alliance between the minority control holder and the corporate management.

(4) Power to change may be located in a control holder whose stockholdings are negligible—possibly nil—but who is in a position to cause the directors of the corporation to resign seriatim and elect successors of the control holder's choosing.<sup>11</sup> Here the power is lodged, not at all in the stock and its vote, but in the personal influence which the control holder has, for extraneous reasons, over the board of directors.

<sup>10</sup> This was the case in *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962).

<sup>11</sup> In *Caplan v. Lionel Corp.*, 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1st Dep't), aff'd mem., 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964), Mr. Roy Cohn held only 3% of the stock of the Lionel Corporation, but he could cause the directors to resign seriatim, and on his instructions to name directors chosen by the purchaser of this 3%.

Conceivably a Svengali holding no stock might be in such a position. Or, perhaps, a gangster group capable of intimidating directors—unhappily, not an impossible situation in some cases.

The four types of situations run the gamut. Power appertaining to stock through its vote to power held quasi-politically through relationship with the corporate management, to power wholly independent of the stock and its rights. Clearly, at one end of the scale we have power exercised in accordance with a system set up by corporation law; at the other, power quite independent of it but still capable of being bought, sold, or quoted. It may be conceded that the rule developed by Professor Andrews will be adequate in the first situation and probably in the second. It becomes hazier when we deal with the third and hardly relevant when applied to the fourth. Whatever the gamut, two quite different legal considerations are apparent.

The law of corporations vests management of the corporation's affairs in its directors.<sup>12</sup> Directors are obliged to manage corporate affairs for the benefit of all of the stockholders (due regard being taken of the corporate contract when there are two or more classes of stock). The stockholder's vote is the means of choosing directors. The stockholder may exercise his vote for personal reasons;<sup>13</sup> he may vote on a measure though he has a personal interest therein separate from other shareholders.<sup>14</sup> He may have a personal interest in choosing a particular slate of directors. His motives ordinarily are not a matter of inquiry—though that rule is principally one of convenience. But the directors, however chosen, can not favor him as against the interest of the corporation. They must act according to their honest business judgment. The assumption is that a majority vote is most likely to produce a board which will consider the interests of the corporation as a whole—a majority indeed have, *prima facie*, the greatest interest in producing this result. Precisely because the stockholder's vote exists for this purpose, he is not allowed to sell it. If, for example, a group seeking control of management of a corporation, but unwilling to buy stock, offered to pay every stockholder one dollar for each vote he cast for their slate, the transaction would be illegal. On proper showing, an injunction would be obtained against the casting of votes thus procured; and probably an election determined by such votes would be set aside. The vote, it thus appears, is a stockholder's right held on a somewhat different basis from the bundle of other rights

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<sup>12</sup> E.g., N.Y. Bus. Corp. Law § 701. Substantially similar conditions appear in the corporation laws of most states.

<sup>13</sup> Stevens, *supra* note 1, § 126, at 567.

<sup>14</sup> *Gamble v. Queens County Water Co.*, 123 N.Y. 91, 25 N.E. 201 (1890).

comprised in a share of stock. It cannot be wholly separated from the main bundle and exercised for a consideration. Equally it cannot be exercised if part of the transaction includes an arrangement that the directors for whom the vote is cast will act against the interests of the corporation or will bind themselves not to use their honest discretion and judgment. Thus it is not fully true that a stockholder may "vote as he pleases" or from any motive he chooses. Briefly, he cannot ordinarily bind the director for whom he votes not to fulfill the duties that director will owe to the corporation when he assumes office. On the other hand he can sell his stock to anyone he pleases and, *prima facie*, for any price he pleases. This is why those seeking to purchase control buy stock and not votes.

Concomitantly, directors cannot ordinarily bind themselves to act in accordance with the instructions of nondirectors—whether or not the outsider is a dominant stockholder, a Svengali, our gangster-intimidator, or possibly a former owner of stock like Mr. Cohn in *Caplan v. Lionel Corp.*<sup>15</sup> He cannot, for example, validly contract to vote as directed to fill a vacancy in the board of directors and resign when requested. Both factors are involved when "control" is transferred under the third and fourth classifications.

It is recognized—as the New York court did in *Essex Universal Corp. v. Yates*<sup>16</sup>—that there are reasonable limits on this rule. In New York, a group of stockholders holding sufficient stock to win an election (even though a minority) may now validly agree to withdraw the directors they have elected when they transfer their shares to a new owner.<sup>17</sup> Whether a director who refused to abide by such an agreement could be compelled to do so by an equity court is uncertain—I should question it. But the desiderata are not too important. If the block of stock transferred can elect a new slate at the next annual meeting, the only point is whether the old directors must stay in office until that time, or may agree to drop out at once in favor of a slate named by the incoming group. The incoming control holder will be able, presumably, to mobilize a majority of votes for its slate in any case a little later. Not much is accomplished by insisting on the right of the lame-duck directors to hold over.

This is markedly different from a situation in which a director, theoretically bound to act in the best interests of the corporation as a whole, can be ordered to fill vacancies and can be ordered to resign by an individual or group who are not substantial owners of stock but merely hold

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<sup>15</sup> See note 11 *supra*.

<sup>16</sup> 305 F.2d 572 (2d Cir. 1962).

<sup>17</sup> *Ibid*; *Caplan v. Lionel Corp.*, 20 App. Div. 2d 301, 303, 246 N.Y.S.2d 913, 915 (1st Dep't), *aff'd mem.*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964).

an influential position (however attained). The buyer of control in this latter case is not buying stock—he is buying directors. If he does not directly bribe the directors to follow his orders and then resign, it is because he can pay an influential holder to produce the same result. “The underlying principle is that the management of a corporation is not the subject of trade and cannot be bought apart from actual stock control . . . .”<sup>18</sup>

Hence the two separate considerations. The stockholder’s vote is a legitimate adjunct of his shares, designed to produce a single result—a management dedicated to the interests of the corporation. The buyer of stock legitimately acquires that right along with his purchase of shares.

Transfer of control by any means other than as an incident of sale of stock loses this legitimacy. The transferor turns over his capacity to cause directors to act for reasons other than those of honest business judgment. This sort of arrangement is contrary to the public policy implicit in the statutory scheme by which corporations are managed.

The difficulty lies with the middle section, especially our third category. The holder of a quite small block of stock, say ten or fifteen per cent, who also has a majority of the board of directors with him, controls the proxy machinery. When the balance of shares are scattered or inert, or have come to rely on the management, they will normally vote the management’s slate. The ten per cent holder in that case can deliver control; but he must unite two processes. He can deliver ten per cent of the votes by selling his stock. He can influence his fellow stockholders by presenting them with a slate of directors chosen by his buyer. Through seriatim resignations, perhaps, he can put the buyer’s slate into directorships before the next election. The price of the shares he sells to his buyer can, and presumably will, include a consideration for his use of influence with the old directors as well as for the transfer of his shares. In some cases the transaction is part legitimate, part not. More accurately, it is part legitimate—the sale of shares—and may or may not be legitimate as to the other element—the use of influence—depending on whether the control seller fulfilled “the fiduciary obligation” referred to by Dean Stevens. That is, whether he observed his duty to exercise his power for the benefit of the corporate group as a whole and not solely for his own interest.

These considerations require qualification of the rule proposed by Professor Andrews.<sup>19</sup> When control is transferred for a consideration, (a) the seller may be selling attributes of his shares which he has a

<sup>18</sup> *Id.* at 303, 246 N.Y.S.2d at 915.

<sup>19</sup> See Andrews, *supra* note 8, and accompanying text.

perfect right to transfer, but which must be transferred with due consideration for the interest of the corporation as a whole. If the sale is at differential over market, the problem is whether the seller can collect the over price, or whether such excess must be shared with his fellow stockholders; or (b) the control holder may be transferring for a consideration extraneous capacity to direct existing directors to turn over the management to someone else—that is, selling his capacity to influence existing directors. This is an attribute he has no right to have, and the existing directors have no right to recognize; or (c) the transaction may contain both elements. Different remedies may be needed.

In the situation presented by (a), other circumstances being absent, nothing improper has been done. The only question is whether there should be equitable assignment to the minority shareholders of a portion of the differential or premium received for the sale of the voting power along with sale of less than all the stock. In the situation presented by (b), raw power has been sold without substantial sale of stock; the transaction is improper; and, in justice to the shareholders, it ought to be blocked and perhaps rescission decreed. They are entitled to a management chosen by shareholders, not by outsiders. The real difficulty arises in the case presented by (c)—where legitimate transfer of a minority of the stock also carries with it control power arising from the relationship between the holders of the minority block and the corporate management, and from control of the nomination and proxy machinery.

## II

### IRRELEVANCE OF "CORPORATE OPPORTUNITY"

One line of analysis of cases arising when control is sold may be briefly examined and dismissed as irrelevant. This is the hazy theory that opportunity to sell control of corporate management is a "corporate opportunity" and the control holder is in equity bound to "offer it to the corporation." This analysis arises, I think, from a misconstruction of the facts in *Perlman v. Feldmann*.<sup>20</sup> There, Newport Steel Corporation (whose control was sold) had a dependable supply of steel in time of shortage. Wilport bought thirty-seven per cent of the stock, "working control," from Newport's president, Feldmann, and his associates, desiring to secure the steel supply for its own operations. It paid not quite double the market price for the stock of Feldmann and his associates. Thereupon Perlman brought a derivative action against Feldmann and his associates, joining Newport as defendant, asking that the differential price

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<sup>20</sup> 219 F.2d 173 (2d Cir. 1955).

paid for control be adjudged an asset of Newport, and that it be applied for equal benefit of all Newport shareholders—presumably through Newport itself. The claim was upheld. The decree, however, did not stop with adjudging that Newport owned the differential. It directed distribution of the pro rata share of the differential directly to the noncontrolling stockholders of Newport. This accomplished the result desired, though technically it short circuited Newport. It is sometimes said that this was not a true case of “sale of control;” that the substance of the transaction was the sale by Newport to Wilport of its preferred position in securing steel, though in form a sale of the controlling stock interest; that, in fact, the real sale was of Newport’s capacity to buy steel.

I do not so construe the case. It is true, of course, that when directors and officers have an opportunity to buy or sell assets which the corporation should buy or sell for the advantage of the enterprise, and consequently for the advantage of all its shareholders, they are required to offer the opportunity to the corporation. But, in fact, no such opportunity was presented to Newport. The buyer did not offer to purchase Newport’s assets and contract position. He offered to buy control of Newport from a group of stockholders. True, he wanted control because Newport would then sell him steel—apparently on the same terms it was selling to other customers. Yet it is hard to spell out any opportunity taken advantage of by Feldmann and his associates which they or the directors withheld from Newport. It was a straight case in which stock of Newport was worth more to the buyers than to anyone else, provided control went with the stock.

Properly, the court decided that the added differential of value inhered in the control holders of Newport, but that they, being obliged to exercise their power for the benefit of all stockholders alike, were obligated to see that all shareholders should receive their pro rata share of the differential. This could have been achieved by directing that the entire differential be paid into the treasury of Newport, thus increasing the value of the noncontrolling shares. Or it could be accomplished (as was done) by short circuiting Newport and giving their pro rata share of the differential directly to the Newport noncontrolling stockholders as a sort of dividend. The only “opportunity” here involved was that of collecting a differential in price over market for the delivery of management to the buyer.

The buyer in *Feldmann*, as in any case in which control is bought, did intend to manipulate the management of the company. But this is always the case. It is the normal reason why control is bought. The buyer may desire to elect himself and his associates to lucrative offices in the corpora-

tion. Or he may desire to connect the corporation's business operations with his own. Or he may desire to merge his acquisition with some other corporation. In *Feldmann* he merely desired a dependable seller of steel.

Now there is nothing inherently or even *prima facie* improper in any of these situations. Absent suspicious circumstances, there is no reason to assume that a control buyer desires to manipulate the management to the disadvantage of the noncontrolling stockholders, though, of course, this may be the fact.<sup>21</sup> Ordinarily, the buyer of control thinks he can do better with the corporation than the old management, and he intends to manipulate its personnel and policies toward that end. Absent an intent to loot or otherwise defraud the corporation, the result should benefit all stockholders alike. It cannot be said, therefore, that the situation in *Feldmann* was peculiar, or different, or distinguishable (save perhaps in degree) from most cases in which control is acquired. There, as in most such cases, the only problem arises from the fact that less than all the shares carry control. Although the management selected by the controlling shareholders must conduct the corporate affairs for the equal benefit of all shareholders, the controlling block of shares can attract to themselves a differential price paid by a buyer to secure capacity to manipulate the management.

### III

#### TRANSFER OF CONTROL BY CORPORATE VOTE

Control may be shifted from one group to another not only by sale but also by direct corporate action, though it raises different considerations. The theory that power to choose management of a corporation, though vested in the shareholders, is an attribute of the corporation, was raised in *Honigman v. Green Giant Co.*<sup>22</sup> There, Green Giant had forty-four outstanding shares of voting stock and nearly 430,000 shares of non-voting stock, the latter originally issued as a stock split or stock dividend to the holders of the voting stock and later sold by them to the public. The two classes of stock were equal in all respects except as to voting power. Thereafter the management submitted to its stockholders an amendment to its articles of incorporation giving effect to a plan of recapitalization. Under it the forty-four voting shares were to be exchanged for 44,000 shares of new voting common stock; each nonvoting share was to receive one share of new voting common. At a duly called meeting of stockholders (including both classes) 92.3 per cent of the nonvoting shares voted in favor of the plan, as did all the voting shares.

<sup>21</sup> *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940); *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 30 N.Y.S.2d 755 (Sup. Ct. N.Y. County 1941).

<sup>22</sup> 309 F.2d 667 (8th Cir. 1962), affirming 208 F. Supp. 754 (D. Minn. 1961).

The voting shareholders thereby relinquished control and, as compensation, their participation (through their stockholdings) in the assets of the company was increased from about 0.01 per cent to 9.2 per cent.

A dissenting shareholder sought to set aside the issuance of the premium shares to the voting stock. The trial court dismissed the complaint. After observing that a burden did rest upon the directors proposing this recapitalization to establish its fairness to the non-consenting stockholders,<sup>23</sup> the court concluded that this burden had been met. It also considered that great weight should be accorded to the overwhelming stockholders' vote in favor of the plan. (It may be noted that the stockholders voting in favor of such a plan would certainly be estopped from complaining.) The court went further, pointing out that since the previously nonvoting shares, now accorded a vote, had promptly risen sharply in market value, a claim that they had been damaged was scarcely in order. No tinge of fraud or misrepresentation clouded the transaction; consequently the vote to amend the charter and recapitalize on the above basis was sustained by the trial judge. His decision was affirmed on appeal.

In the decision, note was taken of the fact that an offer had been made to the holders of the forty-four voting shares of \$2,000,000 for their shares although they represented only 0.01 per cent of the corporate assets. One wonders what would have happened if the sale had been made, and the nonvoting shareholders had brought action along the lines of *Feldmann*. The *Green Giant* decision held only that under the law of Minnesota, through due corporate procedure for recapitalization, *stockholders* may vote to compensate the holders of voting control for giving it up. It does not, and does not purport to, settle the question whether the holders of control can sell their control without liability to account to the corporation or their fellow stockholders. Undoubtedly the Court of Appeals for the Eighth Circuit was not hospitable to the theory that the price of control could belong to someone other than the voting shareholders. But that was not the point of the case.

There is, I suggest, a wide difference between sale of control power to a buyer for a price and corporate action changing voting rights (and with them location of control) honorably submitted to the vote of all the shareholders and voted for by substantially all of them.

#### IV

#### THE WRONG AND ITS REMEDIES

By its corporation statute, the state grants each corporation capacity to choose a board of directors for management of its affairs. It directs

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<sup>23</sup> Honigman v. Green Giant Co., 208 F. Supp. 754 (D. Minn. 1961).

exercise of that capacity through the stockholder's vote. By the certificate of incorporation, it gives the incorporators power to assign the vote evenly among all shares outstanding or evenly among all the shares of a specified class or classes. By statute in most states, and by general doctrine, the rights of each share of stock within each class must be identical.<sup>24</sup> It is wholly impractical to require a unanimous vote to elect directors; consequently in all normal situations a majority is authorized to elect the directors prevailing over the votes of the minority. Essentially, this is nothing more than a device to assure continued management and functioning; it is a corporate power, though exercised by individual stockholders. It does not authorize or permit a management thus constituted to distinguish between majority and minority shareholders: management power does not include that privilege. The position of a majority shareholder, with his capacity to control, is thus not a "property right" in the same sense as is his right to participate in dividends, or in liquidation or the like. His control power is really adventitious, a by-product of the corporate capacity to choose a board of directors by less than unanimity. This is why the control power—capacity to choose a management—is a corporate asset, not an individual one.

The same is true, I think, of "minority control," *i.e.*, a minority block able to mobilize enough additional shares to choose a management by soliciting their proxies. The difference is one of degree, though commercial result may be the same.

The adventitious position of the control holder becomes increasingly less personal as the controlling minority gets smaller and as the distribution of stock is wider. The smaller the control block, the less the minority depends on the vote carried by its block of shares or on its capacity (without aid from the corporation itself) to gain the additional votes needed. The smaller the controlling minority, the more it must rely on its personal relation with the board of directors to obtain use of the proxy machinery. Factually, the controlling minority must, and does, ask the directors of the corporation to place at its disposal a piece of strictly corporate machinery—nomination of a slate and sending out proxies asking a favorable vote on that slate. Where the corporation is sufficiently public, it must ask them to prepare and circulate the execution and distribution of the required proxy statement. By now, "control" is a combination of the individual right of the minority holder to vote his stock plus the probability (which is usually overwhelming) that the scattered stock will fol-

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<sup>24</sup> See, e.g., N.Y. Bus. Corp. Law § 501(c).

Except, of course, where the corporation law sets up a separate arrangement, as, for example, authority to issue preferred stock "in series," each series having different characteristics. See Hornstein, *Corporation Law and Practice* § 125 (1959).

low the slate recommendation of the directors or "management." The second element, crucial in this situation, is purely and simply use of a corporate power; it must be exercised for the equal interest of all. If the minority derives a benefit from its capacity to have such use, that benefit—the resulting "control" position—results far more from corporate action than from any attribute of the minority stockholders' ownership.

Finally, where some individual or group has control purely because of its capacity to cause the corporation to use the proxy machinery and thereby gain a favorable vote, the control position is purely extraneous. Any consideration paid for its use is almost indistinguishable from a bribe paid to induce corporate management to act accordingly.

In the first case, *i.e.*, straight majority control, the power held is legitimate; but any price received for it, apart from the value of the stock without that power, belongs in equity to all the shareholders. The corporate entity may, but need not necessarily, be used as the conduit through which the differential may be distributed so that every stockholder gets his pro rata share.

The same rule I believe applies to the second case—minority control where the minority can mobilize the additional needed margin.

In both situations, it would seem that the remedy may be either (1) recovery of the differential and placing it in the corporate treasury, or (2) recovery of the differential and directing that it be paid as a distribution to all the voting shareholders. This may be accomplished directly, as was done in *Feldmann* to avoid an unnecessary step, by directing payment by the control seller of the proper pro rata share to the noncontrolling shareholders.

Preventively, the remedy suggested by Professor Andrews seems adequate, though it should be recognized as a remedy rather than a right. The control seller can be required to exact from his buyer an agreement to buy all shares offered at the same price as the buyer offers for the shares of the control seller. And, if the buyer is not prepared to make that offer, the control seller may exact an agreement that his buyer will arrange to receive tenders of shares from all stockholders at the price offered the control seller and will allocate his purchases among all selling stockholders in proportion to their tenders. Thus, if the control seller has thirty per cent of the stock—say, 300,000 out of an outstanding million shares—the control buyer may be required to request tenders from all stockholders, agreeing that he will buy 300,000 shares and allocating his purchases pro rata among them. Stockholders who do not tender may be assumed not to want to sell their stock at the price offered; in any case, everyone has had his opportunity to receive for part of his

shares their market value plus their share of the consideration paid for capacity to choose the board of directors.

And where the controlling minority is "thin," *i.e.*, where it depends on willingness of the existing board of directors to use the proxy machinery as the minority control holder directs, further scrutiny may be demanded. In effect, the control seller in such a case is proposing to enter the buyer's slate in the next corporate election, relying primarily on the the inertia of shareholders or perhaps their confidence in the outgoing management to elect it. At this point, the buyer's payment to the minority control holder is made less for his stock than for his influence. This may not be objectionable *per se*—that depends on the circumstances—provided equal opportunity has been given to shareholders as above. But the question necessarily arises whether the transaction should be permitted and the burden of showing its fairness rests on the control seller in case of question. If objectionable, the remedy could be to enjoin any payment to the control seller and to require the attempted buyer to submit his slate of directors at the next election, with appropriate disclosure of all the relevant circumstances, and to enjoin differential payment over market for the shares of the control seller and anyone connected with the management. We are coming unpleasantly close to a situation where a small minority with an adventitious position is selling—for a consideration—management action which should not be for sale at all. A court dealing with an appropriate complaint should have power to determine how the election should be handled.

In the fourth case, *i.e.*, payment to an outsider or a merely nominal stockholder to cause the corporate management to turn over control to the buyer, the transaction is simply contrary to public policy and ought to be enjoined. Rightly or wrongly, the law does require a management chosen by stockholders and does not allow a corporate management, or anyone on its behalf, to sell to outsiders the performance of its managerial function. If management considers change of control desirable in the interests of the corporation, it may go before its stockholders and say so either by proposing a new slate or (in some cases) by the recapitalization route. But neither the management nor anyone on its behalf may take payment for doing so.