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The Fiduciary Duty of Controlling Shareholders

Jerry B. Helwig

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court to modify its decree. This was regarded as a contravention of due process of law. However, the writer feels compelled to agree with the dissenting opinion, in which it was pointed out that in the action on the judgment in the second state, the defendant could always plead discharge of the liability through payment or otherwise. If the actions or change in circumstances of the plaintiff indicated that the defendant's liability should be discharged, the defendant could so argue and comity would probably not be given.

The majority holding in the Griffin case should not affect decisions like that of the California case discussed previously, since that court provided that it would modify its decree if the Missouri decree were later modified. However, there is some doubt in the mind of the writer as to the propriety of judgments (on non-final judgments) which do not contain such a provision. The Griffin case does not decide this point.

It should be evident that the doctrine of judicial comity as to judgments of sister states is narrowly wedged between the full faith and credit clause on the one hand and the due process clause on the other. However, as has been pointed out, the holding that there is no obligation to enforce under full faith and credit does not ipso facto lead to the conclusion that there is an obligation not to enforce. That obligation only arises when the first court did not have jurisdiction over the parties or the subject matter.

KEITH E. SPERO

The Fiduciary Duty of Controlling Shareholders

INTRODUCTION

In recent years, the courts have imposed upon controlling shareholders, in their dealings with their corporations, standards similar to those which govern trustees. While corporation charters rarely place specific

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25 Fall v. Eastm, 215 U.S. 1 (1909) affirmed the principle that the courts of one state cannot by in rem proceedings adjudicate and pass title to land in another state. However, Burnley v. Stevenson, 24 Ohio St. 474 (1873) and Norton v. House of Mercy of New York, 101 Fed. 382 (5th Cir. 1900) stand for the principle that an in personam decree as to title to lands located in another state is conclusive between the parties and their privies in a later action in the other state. The doctrine of comity was not discussed in these cases.

It would seem that Fall v. Eastm would limit the right of a court to recognize a sister state's decree which in rem transferred title to land beyond the court's jurisdiction. Since the court did not have jurisdiction over the subject matter, no recognition should be possible, even upon the grounds of comity.
fiduciary limitations upon the powers of majority stockholders, equity
courts have reached the conclusion that these powers are not absolute.
Thus every action of majority interests is potentially subject to close
scrutiny by the equity courts. The rules in application are less rigorous,
however, than in the case of actual trust relationships, since the business
situation demands greater flexibility. The fundamental objective
of the courts is to protect the interests of minority stockholders
in corporate property. At the same time, the ideal of sound discretion
in management has been an effective counterweight to unlimited judi-
cial review of corporate action.

While reference is often made to the obligations of a "majority"
shareholder, it is clear that ownership of more than fifty per cent of the
voting stock is not essential to the imposition of fiduciary obligations.
In fact, this will rarely be the case in a corporation of any size. The term,
"majority," is universally employed to justify the recognition of a fidu-
ciary relationship whenever effective control is exercised over corporate
affairs, as by use of proxy machinery or capitalization upon widespread
stockholder apathy.\(^1\) Furthermore, as long as effective control is actually
exercised, equity courts will not hesitate to impose fiduciary standards,
although this domination is obtained indirectly, such as by means of a
subsidiary corporation.\(^2\)

In the sense that the business which a majority stockholder transacts
is for the benefit of the corporation or the minority shareholders, he acts
in a fiduciary capacity. In this capacity, the majority shareholder stands
in a relation of trust and confidence, and owes a high degree of good
faith.\(^3\) In applying this concept to corporate controversies, the duties
and relationships of directors and controlling stockholders can not be
completely segregated. In most instances, those who hold the majority
interests will either be members of the board of directors, or will control
the board members. Nor is it possible in this area to ignore the influ-
ence of policy considerations which induce the courts to subject corpo-
rate action to judicial review, or the confusion caused by misapplication
of principles stemming from intricate fact situations.\(^4\)

\(^1\) Hyams v. Calumet & Heca Mining Co., 221 Fed. 529 (6th Cir. 1915); Kavan-
ough v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919); White v.
Kincaid, 149 N.C. 415, 63 S.E. 109 (1908).

\(^2\) The doctrine by which the holders of a majority of the stock of a corporation who
dominate its affairs are held to act as trustees for the minority, does not rest upon
technical distinctions. The corporate entity will not be regarded when to do so
would work fraud and injustice. See Southern Pacific Co. v. Bogert, 250 U.S. 483

\(^3\) Fletcher, Private Corporations § 838 (1947 ed.)

\(^4\) "The complexities of cases involving liability for transfer of corporate management
are so great and the facts so diverse and complicated that excerpts from court opin-
Herein, primary emphasis will be placed upon the extent to which the fiduciary concept has influenced the course of decision. After a brief consideration of the early general principles, and the exceptions thereto, attention will be devoted to the two areas in which the fiduciary relation has been recognized to date: (1) mismanagement of corporate property and (2) the sale of the controlling interest. At the outset, it must be emphasized that courts of equity have recognized the marked social benefits to be derived from the imposition of a strict fiduciary standard, but have been unwilling to destroy the flexibility and desirable discretion in corporate management.5

**EARLY GENERAL PRINCIPLES**

As set forth in the leading case of *Windmuller v. Standard Distilling Company,*6 the early view promulgated by the equity courts was that stockholders of a corporation, unlike directors, were not in any sense trustees for the other stockholders. Rather, each stockholder represented solely his own interests in corporate affairs, and could act upon personal motives even though adverse to the interests of other shareholders. This view found expression in the vast majority of the early disputes arising out of alleged wrongful conduct on the part of controlling stockholders.7 It soon became well settled that a majority stockholder was not made a trustee for the minority shareholders in any sense by the mere fact that he held a majority of the stock, or by the further fact that he used the voting power of his stock to elect the board of directors.8 Furthermore, equity courts, favoring the ready transferability of corporate shares whenever and to whomever their owner desired, were particularly emphatic at this time in holding that no fiduciary duty was owed when the controlling stockholders sold their stock to outsiders.9

Notwithstanding this rather absolute view toward the non-existence

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5 See Note, 35 COL. L REV. 1167, 1178 (1935).
6 114 Fed. 491, 494 (3d Cir. 1902). Kirkpatrick, J., stressed that no authority had been referred which holds that one stockholder is in any sense a trustee for other stockholders.
7 Thurmond v. Paragon Colliery Co., 82 W Va. 49, 95 S.E. 816 (1918); Haldeman v. Haldeman, 176 Ky. 635, 197 S.W. 376 (1917); Gamble v. Queens County Water Co., 123 N.Y. 91, 25 N.E. 201 (1890); 13 FLETCHER, PRIVATE CORPORATIONS § 5811 (1943 ed.).
of fiduciary obligations, courts of equity soon began to grant relief at the instance of injured minority shareholders, in certain aggravated situations. Thus, where dominant stockholders used their power to benefit themselves at the expense of the minority in such a manner as to "shock the conscience of the court," their conduct was deemed fraudulent, and equity afforded the minority appropriate relief.10 Also, the majority stockholders were held to have some duty to protect the interests of the minority when they undertook to run the corporation without giving the minority any voice in its management.11 In addition, when controlling shareholders conspired with the directors, who were regarded as the trustees of all, to deprive other stockholders of their property, equity would intervene to see that justice was done.12 Finally, it was clear that the majority interests could not sell, or cause to be sold, corporate assets and retain the consideration.13

Thus the principle of equity jurisprudence, as enunciated in the Windmuller case, was generally accepted prior to the twentieth century; there was no fiduciary relation in any sense among corporate stockholders. Relief would be granted only in the most extreme instances, and then upon familiar tort concepts such as fraud. It is interesting to note that this view still persists to a substantial extent in at least one jurisdiction today.14

MISMANAGEMENT OF CORPORATE PROPERTY

In an increasing number of cases, however, the equity courts were faced with situations in which minority shareholders alleged that controlling groups had mismanaged the property of the corporation itself. Such conduct was deemed wrongful, not in the sense of unwise business

11 Tower Hill-Connellsville Coke Co. v. Piedmont Coal Co. 64 F.2d 817 (4th Cir. 1933).
13 Thurmond v. Paragon Colliery Co., 82 W Va. 49, 95 S.E. 816 (1918); Menier v. Telegraph Works, L. R. 9 Ch. 350 (1873)
14 Maurs v. Madden, 307 Mass. 378, 380, 30 N.E.2d 242, 244 (1940) The Massachusetts court held that mere ownership of stock does not create a fiduciary relation between the stockholders. In the absence of fraud, conspiracy or coercion, the rule is clear that a stockholder has the right to purchase the majority of stock for the purpose of gaining control of the company, even though such results in injury to minority interests.
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judgment, but rather as constituting misappropriation of funds, unfair
distribution of corporate profits, or dissolution of the business entity to
serve the personal ends of the majority. Instead of basing liability upon
traditional concepts of fraud and conspiracy, the Supreme Court of the
United States at an early date recognized a fiduciary obligation on the
part of the controlling interests in the landmark case of Jackson v.
Ludeling. There, persons with a common interest in the corporation,
although not trustees technically or in form, were held to be trustees in
a very real sense. Relying upon the Jackson case, a federal court of ap-
peals held in Wheeler v. Abilene National Bank that the controlling
shareholder breached his fiduciary obligation by selling corporate prop-
erty to himself for an inadequate consideration:

The holder of the majority of the stock of a corporation has the power,
by the election of biddable directors and by the vote of his stock, to do
everything that the corporation can do. His power to control and direct
the action of the corporation places him in its shoes, and constitutes him
the actual, if not the technical, trustee for the holders of the minority of
the stock.

Unwilling at this time to depart entirely from announced principles,
the equity courts recognized a fiduciary obligation only when the ma-
jority shareholders dictated the acts of the directors and the corporation.
To that extent, the court regarded the stockholders as "directors in fact,"
and thus imposed the same relation of trust required of the directors.
In such cases, the courts applied "principles of natural justice," and con-
sidered the majority to be real, if not technical or formal, trustees for
other stockholders, so that any use by them of corporate property for
their own profit was a breach of their trust.

The traditional basis for this fiduciary relationship was expressed in
the legal theory that a community of interest in common property im-
possed a community of duty and mutual obligation to do nothing to im-
pair the property at the expense of others who have similar rights in it.
This community of interest placed upon the majority stockholder the
duty to exercise good faith, care and diligence to make the corporate
property produce the largest possible return, to protect the interests of

*88 U.S. (21 Wall.) 616 (1874)
**159 Fed. 391 (8th Cir. 1908).
*Id. at 393, 394.
Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); White v. Kincard, 149 N.C.
415, 63 S.E. 109 (1908); Crichton v. Webb Press Co., 113 La. 167, 36 So. 926
(1904).
*Jones v. Missouri-Edison Electric Co., 144 Fed. 765 (8th Cir. 1906); Glengary
minority shareholders, and to secure and deliver to the minority their just proportion of the income and proceeds of the property.\textsuperscript{21} Once the fiduciary relation was recognized, the burden was placed upon the controlling stockholder to show fairness, reasonableness and good faith.\textsuperscript{22}

Thus, the earliest departure from the rule that stockholders were in no sense trustees for each other was made when the majority shareholders \textit{actually} controlled and then mismanaged the corporate property, in which there was a "community of interest" among all shareholders. It should be recognized that many courts at first paid lip-service to this trust concept, but in fact continued to apply familiar principles sounding in \textit{tort}.\textsuperscript{23}

In the more recent cases dealing with alleged mismanagement of corporate assets, this fiduciary relation has become more firmly established. The vast majority of courts have expressly repudiated prior decisions which based liability upon fraudulent or other tortious conduct.\textsuperscript{24} Furthermore, most courts have begun to place greater emphasis upon the \textit{power} of majority stockholders to control corporate property and affairs by virtue of their stock ownership, and no longer require \textit{actual} domination on the part of directors before a fiduciary relation will be recognized.\textsuperscript{25}

In the absence of actual control of corporate affairs by dominant shareholders, however, some courts still refuse to impose fiduciary duties. This view is illustrated by the leading New York case of \textit{Blausten v. Pan American Petroleum Co.}.\textsuperscript{26}

Mere ownership of a majority of a corporation does not in and of itself spell dominion. Stockholders are not \textit{ipso facto} trustees for each other. The fiduciary role is not assumed, and the obligation will not be imposed, until a majority stockholder usurps the functions of the directors in the

\textsuperscript{22} Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892).
\textsuperscript{23} The majority must act in good faith and within their powers, but courts have indicated that no principle of law is more firmly fixed in our jurisprudence than the one which declares that courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs. See Feess v. Mechanics' State Bank, 84 Kan. 828, 115 Pac. 563 (1911); cf. White v. Kincaid, 149 N.C. 415, 63 S.E. 109 (1908).
\textsuperscript{24} Backus v. Finkelstein, 23 F.2d 531 (4th D. Minn. 1924), \textit{aff'd mem.}, 31 F.2d 1011 (8th Cir. 1929); Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919).
\textsuperscript{25} "Majority stockholders having the right and power to control occupy a fiduciary relation toward the minority to the same extent as the corporation or its officers and directors." Overfield v. Penaroad Corp., 42 F. Supp. 586 (E.D. Pa. 1941); see Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); Nave-McCord Co. v. Ranney, 29 F.2d 383 (8th Cir. 1928).
\textsuperscript{26} 263 App. Div. 97, 119, 31 N.Y.S.2d 934, 956 (1st Dep't 1941), \textit{aff'd}, 293 N.Y. 281, 56 N.E.2d 705 (1944).
management and conduct of the business of the corporation to the detri-
ment of the corporation and the minority.

It should be clearly recognized that this requirement of actual domi-
nation of directors relates only to the existence of the fiduciary relation. The Blaustem case would appear to represent a strong but minority view that before a majority shareholder may be held as a "fiduciary," minority stockholders have the burden of proving that the majority interests domi-
nated and controlled the directors in their conduct of corporate affairs. Even under this view, it is generally held that where a controlling share-
holder seeks to appropriate to himself corporate property, to the exclusion and injury of minority stockholders, fiduciary obligations will be im-
posed.27

Once the fiduciary relation is shown to exist, it is universally held
that the majority shareholder has the burden of showing good faith and
fair dealing in his relations with the corporation and the minority stock-
holders, and not merely a burden of going forward with evidence.28 In
applying this fiduciary obligation to specific fact situations, early courts
were content to use such vague standards as the "highest good faith, care
and diligence."29 In recent litigation, however, some courts have gone
to considerable lengths to define more clearly the standard of care owed
by the controlling shareholders. Perhaps one of the most enlightening
statements is that set forth in Lebold v. Inland Steel Company.30

The vote of every director and of every majority shareholder must be
directed to and controlled by the guiding question of what is best for the
corporation, for which he is, to all legal intents and purposes, trustee. In
his voting, in his management, he is bound to be wholeheartedly, earnestly
and honestly faithful to his corporation and its best interests; his own
selfish interests must be ignored. If when he votes he does so against the
interest of his company, against the interest of the minority and in favor of
his own interest, by such selfish action, by omission of fidelity to his own
duty as a trustee, he forfeits approval in a court of equity.

In contrast, the Supreme Court of the United States has stated that
"the essence of the test is whether or not under all the circumstances the
transaction carries the earmarks of an arm's length bargain."31 Unfortunately, however, most courts still cling to the traditional view that where

27 Allied Chemical & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 Atl. 486
(1923).
586 (E.D. Pa. 1941); Singer v. Carlisle, 26 N.Y.S.2d 172 (Sup. Ct. 1940), aff'd
mem., 261 App. Div. 897, 26 N.Y.S.2d 320 (1st Dep't 1941); Garrett v. Reid-
Cashion Land & Cattle Co., 34 Ariz. 245, 270 Pac. 1044 (1928).
29 See note 21 supra.
30 125 F.2d 369, 372 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1942).
the dealings of a majority shareholder with the corporation are challenged, the burden is on the majority stockholder not only to prove the good faith of the transaction, but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.\textsuperscript{32} Imposition of this burden of proof upon the controlling shareholder is primarily justified by the inherent nature of the fiduciary obligation. Also to be considered is the practical fact that majority interests usually have control of corporate records and are in a superior position to offer proof upon any matter affecting their conduct with the corporation.

It would seem that the application of the ambiguous standards of "good faith" and "fairness" alone will not lead to a satisfactory solution of the complex fact situations presented in modern corporate litigation, since the majority usually is able to suggest some business justification for their acts. A few courts have shown a willingness to impose liability without regard to the fairness or good faith of controlling shareholders, where their conflicting interests prevent any fulfillment of fiduciary obligations.\textsuperscript{33} It is generally regarded, however, that this high standard should be reserved for the most extreme acts of bad faith. Rather, every effort should be made to define more clearly the "good faith" standard, as was done in the \textit{Lebold} case. In this manner, a more workable standard may be provided, and yet a flexibility and sound discretion in corporate management preserved.

Finally, some attention should be devoted to the type of suit which may be brought to remedy a breach of fiduciary duty by the controlling stockholder, in managing the corporate property. As to federal proceedings, in the leading case of \textit{Zahn v. Transamerica Corp.},\textsuperscript{84} it was held that a minority shareholder may bring the action as a spurious class suit under Rule 23(a) (3) of the Federal Rules of Civil Procedure,\textsuperscript{38} and that a


\textsuperscript{33} Courts have refused to consider evidence offered by majority stockholders to prove their good faith and the fairness of their conduct, if their personal interests were so strong as to preclude fulfillment of fiduciary duties. See Irving Trust Co. v. Deutsch, 73 F.2d 121 (2d Cir. 1934); Overfield v. Pennroad Corp., 42 F. Supp. 586 (E.D. Pa. 1941); Singer v. Carlisle, 26 N.Y.S.2d 172 (Sup. Ct. 1940), \textit{aff'd mem.,} 261 App. Div. 897, 26 N.Y.S.2d 320 (1st Dep't 1940); Guth v. Loft, 5 A.2d 503 (Sup. Ct. Del. 1939).

\textsuperscript{84} 162 F.2d 36 (3rd Cir. 1947).

\textsuperscript{38} FED. R. CIV. P. 23(a) (3) "If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is several, and there is a common question of law or fact affecting the several rights and a common relief is sought."
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minority stockholder suing in a class suit need not be a shareholder at the time the wrongful act occurred. In contrast, while a derivative action may be maintained by a stockholder to enforce a corporate cause of action for misappropriation of business assets, under Rule 23(b) of the Federal Rules, it is clear that such derivative action may be brought only by one who was a stockholder at the time the cause of action arose, unless his stock later devolved on him by operation of law. Similar problems are encountered in state court proceedings with specific rules dependent upon statutory enactment or judicial decision in the particular state in question.

As a result of this development, it is uniformly held that the fiduciary obligation of controlling shareholders to both the corporation and minority stockholders may be breached if the majority mismanages corporate property, largely because of the “community of interest” existing as to such business assets. There is still some conflict as to the precise point at which this relation of trust arises. The modern tendency is apparently toward a recognition of fiduciary duties merely by virtue of the majority’s power to control through ownership of the controlling block of stock. It is thus no longer open to dispute that there exists a trust relationship, in a very real sense, as to corporate property.

In this light, it would seem illogical to recognize a fiduciary obligation only where the majority stockholder has usurped the power of the directors to control, as under the New York view expressed in the Blau-stein case. Not only is a difficult question of fact presented as to when the power of directors is actually “usurped,” but this view also ignores the very significant fact that majority interests may effectively misappropriate corporate funds without ever assuming powers of the directors, as by dissolution of the business entity and subsequent purchase of the corporate assets. If it is conceded that the fiduciary concept has genuine social value as a deterrent to corporate mismanagement, it would appear advisable to impose fiduciary duties upon majority stockholders merely by virtue of their power to control corporate affairs.

Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947); Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1941); Heffern Co-Op. v. Gauthier, 22 Ariz. 67, 193 Pac. 1021 (1920).

FED. R. CIV. P. 23 (b) (1) “In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law.”

See Annot., 172 A.L.R. 512 (1948).
SALE OF THE CONTROLLING INTEREST

The sale by a controlling shareholder of his entire interest to an outsider has presented many vexing problems to equity courts. This is particularly true in situations in which the purchaser has proceeded to loot the corporation, and minority interests seek to recover damages for such loss from the former majority stockholder. Business convenience, as well as the traditional concept of private property, favors the ready transferability of corporate shares whenever and to whomever their owner desires. And the courts have generally stated that such is the policy of the law, noting that a share of stock is the private property of its owner, and that there is no "community of interest" in the stock as compared to the corporate assets.39

It has been widely held that owners may demand a premium price for shares needed to control the corporation, since it is deemed only fair that stockholders should be permitted to capitalize upon the control value of their shares.40 On the other hand, majority shareholders who have advised the minority to sell their holdings have in certain instances been held accountable for profits derived from secret agreements to sell their own shares at a higher price.41 But shareholders in early cases—at least in the absence of fraud or misrepresentation—were permitted to retain secret profits arising out of the control incident to their stock, on the ground that no fiduciary duty existed to account for their gains.42

A limitation on the broad doctrine which allows the transfer of control at a premium, however, was delineated by the decision in Insur-...shares Corp. v. Northern Fiscal Corp.43 The court held the controlling...
shareholders in an investment company liable for the transfer of shares to an irresponsible group which later defrauded the company.

Those who control a corporation owe some duty to the corporation in respect of the transfer of control to outsiders. The law has long ago reached the point where it is recognized that such persons may not be wholly oblivious of the interests of everyone but themselves, even in the act of parting with control, and that under certain circumstances, they may be held liable for whatever injury to the corporation made possible by the transfer. It may be said that the owners of control are under a duty not to transfer it to outsiders if the circumstances surrounding the proposed transfer are such as to awaken suspicion and put a prudent man on his guard.

The court in the *Insuranshares* case thus recognized a duty on the part of the majority stockholders to exercise reasonable care to protect corporate interests in transferring their control, this duty stemming from the fiduciary relationship existing as to the corporation and the minority interests. The court realized that it was imposing a high duty upon businessmen to require "searching inquiries which might result in disclosing facts which would upset an advantageous and apparently perfectly legal piece of business." Nevertheless, the court held such duty of active vigilance and inquiry was essential to protect corporate property. In so holding, the court was undoubtedly motivated by the fact that the looting of investment companies had become more or less commonplace since 1929.

In the *Insuranshares* decision, the court expressly rejected the defendant's assertion that the duty does not arise until controlling shareholders take upon themselves the powers of directors, and that a fiduciary obligation is owed only with regard to dealings with corporate property and could never attach to personal stock transactions. In the absence of bad faith or negligence on the part of the majority, this court did not question the legality of a sale of controlling shares. But the court indicated clearly that the majority owes certain minimum obligations in selling its interest to exercise due care to guard against sale to a fraudulent buyer. This view was based upon the fiduciary relation existing among the shareholders, and has received considerable application in succeeding cases.

The New York Court in *Levy v. American Beverage Corp.*, however,
refused to impose a duty of inquiry, and denied recovery when there was insufficient evidence that controlling shareholders knew that the purchaser of the stock would defraud the corporation. The court distinguished the Insuranshares case, stressing that in that case plenary power to sell corporate assets in the form of readily salable securities went with control. In deciding the Levy case, the court emphasized several significant principles:

A stockholder in selling his stock to a stranger, is not a trustee for other stockholders. This would seem to be so though a stockholder sold a majority of the stock. Of course, a majority stockholder may not knowingly use his position to wrongfully injure one who holds a minority interest, and will incur liability when he does so. The test of common honesty would seem to be a sufficient one to apply in order to determine when a wrong is being done. To apply the rigid rules limiting a fiduciary, and to say further that the failure to investigate the moral character, or financial ability of the purchaser of one's stock is an actionable wrong, is to place an unwarranted burden upon the ownership of stock.49

Once again, the New York court emphasized that a controlling stockholder becomes a fiduciary only when he steps out of his role as a stockholder, and acts in the management and conduct of the corporation. The court then limited this fiduciary relation largely to situations involving mismanagement of corporate property. While an earlier New York decision had indicated that gross excessiveness of price for the stock might be sufficient to charge a controlling stockholder with notice of a fraudulent intent on the part of a buyer,50 in the Levy case the court held that since control might have lawful advantages, realization of more than the market price of the stock would not necessarily be indicative of fraud.

Although the court in the Levy case was unwilling to recognize a fiduciary obligation on the part of the controlling shareholders in selling their stock, it did indicate in dictum that liability would result if the defendant had knowledge that the purchaser intended to loot the corporate treasury, or had previously engaged in such practices. But liability for such an act would not be predicated upon breach of a fiduciary obligation. Such conduct would amount to a willful and malicious injury, tortious in its very nature. While the Levy decision distinguishes the facts of the Insuranshares case, it is apparent that the two holdings are in conflict with regard to the underlying question of the fiduciary obligations owed upon a sale of the controlling interest.

The recent federal decision of Perlman v. Feldman51 raises the possibility that restrictions upon the right of a controlling shareholder to dispose

49 Id. at 216, 218; 38 N.Y.S.2d 524, 526.
of his interest may be greatly increased. Minority shareholders brought a derivative action to recover from a former controlling stockholder profits resulting from the sale of his stock to the users of the corporate product. The plaintiff contended that the consideration paid for the stock included compensation for the sale of a corporate asset, a power held in trust for the corporation by the majority. This power was alleged to be the ability to control the allocation of the corporate product in a time of short supply, through control of the board of directors.

The district court held that the power of a controlling block of stock to control management and the distribution of the corporation product, is not a "corporate asset," but rather an attribute inseparably attaching to the stock, which the dominant shareholder could transfer without breach of any fiduciary obligation. In reversing, the court of appeals did not expressly refer to the power to allocate the company's product as a corporate asset. The court based its decision upon the majority shareholder's fiduciary relation to the corporation, and on the loss of "corporate opportunity" — the opportunity to exact a premium for its product. In fact, the court expressly emphasized that a majority stockholder need not account for profits to minority interests every time he sells his shares. Rather, the court indicated that at a time when, because of a heavy demand, the company's product commands an unusually large premium, the fiduciary may not appropriate to himself the value of this premium. On this basis, the court of appeals held that the defendant must account to minority shareholders in their own right, to the extent that the price received for his stock included compensation for such a premium, despite the seemingly impossible task of trying to estimate the amount of such premium. In so holding the court ignored both the Insursahares and Levy decisions, although it would seem clear that the majority shareholder had reason to know that the injury to the corporation would result, thus bringing the controversy within the Insursahares doctrine.

In a vigorous dissent in the Perlman case, Judge Swan criticized the

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52 This theory has been vigorously advocated by A. A. Berle, Jr., BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 244 (1933).
55 Perlman v. Feldman, 219 F.2d 173, 179 (2d Cir. 1955). Judge Swan, in dissenting, states the rule to be: "If the controlling shareholder knows or has reason to believe that the purchaser intends to exercise to the detriment of the corporation the power of management acquired by the purchase, such knowledge or reasonable suspicion will terminate the dominant shareholder's privilege to sell and will create a duty not to transfer the power of management to such purchaser. The duty seems to me to resemble the obligation which everyone is under not to assist another to commit a tort, rather than the obligation of a fiduciary."
majority's holding that control is a corporate asset. Instead, Judge Swan invoked the rule set forth in the _Levy_ case, that a controlling shareholder is under a duty not to transfer his interests only when he knows, or is held to know, that the buyer intends to cause injury to the company. In this regard, it is interesting to note that the _Perlman_ decision has been approved in a recent New York case. The court there held that a derivative action could be maintained, on the sale of controlling stock, to compel an accounting for that share of the profit which is attributable to sale of corporate power, in the form of control of the board of directors. The _Levy_ case was not expressly repudiated since the plaintiff also alleged that the defendant _knew_ that the purchaser intended to defraud the corporation, but the terms of the decision indicate that the _Levy_ rationale has lost much of its vitality.

While there is thus some conflict as to the existence of a fiduciary obligation when the majority transfers its controlling interest, the modern trend is to recognize a trust relation in this situation also. In particular, it is uniformly held that liability will result if the majority stockholder _knows_ that the purchaser intends to loot the corporation, or the facts are so clear that such knowledge may not be denied. There exists a conflict as to the basis of liability, however, when the fiduciary obligation is breached by the transfer of controlling stock, resulting in a loss to both the corporation and minority shareholders.

Liability may be predicated upon a failure to make a reasonable inquiry, as required of a fiduciary under the _Insuranshares_ rationale. This fiduciary duty appears more likely to be recognized in cases where the minority shareholders bring the action in a class suit, since the fiduciary obligations of the majority toward the minority interests are more clearly established than those to the corporation itself. Despite possible difficulties in defining the scope of reasonable care in stock transactions and possible restrictions on transfer imposed by the duty of active vigilance and inquiry, the _Insuranshares_ approach seems to be sound. While traditional concepts of private property favor free alienability of corporate shares, the courts properly have recognized the menace of the corporation raider in imposing upon controlling shareholders a duty to exercise due care to protect the interests of the corporation and minority stockholders.

Liability, on the other hand, may be founded on the receipt of compensation for the sale of a corporate asset, as set forth by the _Perlman_ decision. This doctrine is more likely to find application in a derivative action, where a corporate cause of action is essential. The result reached

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under this view is undoubtedly a just one, but there is created an extremely unwieldy doctrine. All sales of controlling blocks of stock are subjected to the question of whether part of the control sold was an asset of the corporation. In addition, it may well be doubted whether the power to control is properly described as a corporate asset, since such control, as the term is used in any meaningful sense, may actually be exercised only by controlling shareholders.

Whatever basis of liability is applied in a particular controversy, it is no longer open to dispute that shareholders owe certain obligations to the minority interests and the corporation in transferring control to outsiders. While some question may be raised as to whether this duty is fiduciary or based on tort, the modern tendency appears to be toward the imposition of a strict fiduciary standard in situations in which there has been a sale of a controlling block of stock.

CONCLUSION

The impact of the fiduciary concept is indeed significant. It is now recognized that fiduciary obligations on the part of majority interests are owed both to minority shareholders and to the corporation itself, particularly in cases in which controlling shareholders mismanage corporate property. To obtain a satisfactory solution to the problems presented by the complex fact situations of modern corporate litigation, however, there is a need for clarity of thought and precision of analysis. It should be recognized that the same considerations are not present in cases involving the business assets of the corporation or in those concerning a sale of corporate stock, although a fiduciary relationship may exist in both instances. It is essential that the precise nature of the fiduciary concept be carefully examined in each situation. In such an examination the following questions are significant:

(1) To whom is the controlling shareholder a fiduciary?
(2) What obligations are owed by the controlling shareholder as a fiduciary?
(3) In what respect has the controlling shareholder failed to discharge these obligations?

From such an analysis, sound principles may emerge. While the recognition of the fiduciary concept unquestionably represents a significant deterrent to corporate mismanagement and irresponsibility, it should not be employed to enable minority stockholders to dictate in corporate affairs. The judicial objective in imposing a strict fiduciary standard should be to secure marked social benefits without destroying flexibility and sound discretion in corporate management.

JERRY B. HELWIG