

**PERLMAN v. FELDMANN:
A CASE STUDY IN CONTEMPORARY
CORPORATE LEGAL HISTORY**

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INTRODUCTION

When I was a law student, taking a course in introductory corporate law, what was heard around the halls was that most of corporate law would be learned if one understood *Perlman v. Feldmann*. I agree with that statement, and I have agreed more strongly each year I myself have taught introductory corporate law. Indeed, I now believe one would also learn a good deal about the significance of the corporation in American life during the past two decades. Unfortunately, however, it seems to me—on the basis of having read everything of which I was aware concerning one of the most widely discussed cases of recent times—that very few lawyers understand the meaning of that decision.

A. The Transaction

(i)

The results of the remand ordered by the Second Circuit Court of Appeals were reported in the *New York Times* on July 19, 1957, in a story headlined "Stockholders Win Suit for 2 Million" and datelined "Stamford, Conn., July 18 (AP)":

District Court Judge Robert P. Anderson today ordered C. Russell Feldmann of Stamford to pay \$2,000,000 to stockholders of a company of which he once was president. The suit was brought by a group of stockholders of the Newport Steel Company of Newport, Ky. . . .

Merritt, Chapman & Scott is said to hold most of the Newport stock.¹

(ii)²

Charles Russell Feldmann was born on February 8, 1898, in Philadelphia to devout Quaker parents who moved to New York seven years later. While attending public grammar school, he worked in a silent movie theater changing reels for \$2 per week. He attended day, and then evening high school, and in 1913 began working as an office boy for Robert Garden, a Pierce-Arrow automobile distributor in New York, and the father of Mary Garden, the opera singer.

Four years later, Feldmann joined a firm installing new production and cost systems in the leather industry. On June 14, 1919, having saved \$1,000 for a wedding trip, he married Charlotte M. Vega, who persuaded him to use \$600 to purchase an industrial leather belting manufacturing and repair company, which was sold

¹ N. Y. Times, July 19, 1957, at 22, col. 2.

² The material in this section is based upon the following: the entry for Feldmann in WHO'S WHO IN AMERICA 1970-71; a biographic essay entitled "Personality: Expansion Through Mergers" in the N.Y. Times, July 3, 1966, §3, at 3, col. 3; Feldmann's testimony in *Perlman v. Feldmann* as contained in the Appendix to Brief for Defendants-Appellees, *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955) [hereinafter referred to as Defendants' Brief] at 93b-97b; and Findings of Fact 5, 12, 13, 14, 16, and 19, *Perlman v. Feldmann*, 154 F. Supp. 436, 437-38 (D. Conn. 1957).

in 1925. Charlotte had siblings named John and Josephine, and she and Russell had three daughters: Carolyn, married to John F. Otto; Phyllis, married to Joseph V. McKee, Jr.; and Barbara Jane.

From 1925 to 1927, Feldmann operated in industrial real estate,³ and in 1928—having previously, together with C. L. Cummings, entered the first diesel-powered racing car to run on the Indianapolis Speedway—he purchased, reorganized and sold to Alfred P. Sloane the Winton Engine Company, which became the nucleus for General Motors' diesel division.⁴

In the latter part of that year, Feldmann formed the Automobile Radio Corporation—the first company to install a radio in an automobile commercially—a half interest in which was purchased by the Chrysler Corporation one year later. As Philco Corporation became interested in the operation in November, 1930, a new corporation known as Transitone Automobile Radio Corporation was formed, from which Feldmann resigned as president in 1937 and acquired 87 percent of the Simplex Radio Company, the controlling interest in which he sold to Philco early the following year.

By 1940, Philco had acquired all of Feldmann's interests in both Simplex and Transitone, and in November or December of that year, Feldmann acquired the controlling interest in, and became the president of, the Foster Machine Company, which later that year purchased the International Machine Tool Company. In 1942, Feldmann acquired the controlling interest in Strong, Carlisle & Hammond Company of Cleveland, Ohio, which acquired almost all of the stock of the Detrola Corporation, a manufacturer of radios and phonographs. The following year the latter was

³ According to a story in the *New York Times* of October 18, 1970, § 8, at 10, col. 1, "McGraw Hill Building to Be Rerented." Feldmann in 1967 acquired the old Sunshine Biscuit plant in Queens which he turned into the Long Island City Mart and "reportedly paid close to \$20-million for the 34-story McGraw-Hill tower."

⁴ The description given in the text is based on the *Who's Who* entry and the *New York Times* biographic essay, note 2, *supra*. In *My Years with General Motors* (1963), Alfred P. Sloan, Jr. notes that "After [Charles F.] Kettering bought himself a diesel-powered yacht in April 1928, these engines became a major preoccupation of his," that "Mr. Kettering became acquainted with [George W. Codrington, the president of Winton.] as the result of ordering Winton engines for his second yacht. He bought those engines simply because Codrington agreed, though reluctantly, to put in a new kind of injector that one of the Winton engineers was developing at the time, and which Mr. Kettering felt held great promise. I don't know who first suggested the idea of Winton's coming into General Motors. In any event, we began to negotiate formally in the late summer of 1929. Agreement on the purchase of Winton had almost been reached in October when the great market crash temporarily confused the picture," and that "[f]inally, in June 1930 the Winton operations became a part of General Motors with Mr. Codrington continuing as president. Winton's principal market continued to be in large marine engines. (footnote omitted)." *Id.* at 346-47.

merged with the International Machine Tool Corporation, and the resulting company—in 1945—acquired a manufacturer of refrigerator units, the Universal Cooler Company. This company had a wholly owned Canadian subsidiary (Utah Radio Products) which manufactured radio interiors and transformers and which had a wholly owned subsidiary, Caswell-Runyan Company—a manufacturer of radio and television cabinets—which in turn had a subsidiary known as the Goshen Veneer Company, which made veneered panels for such cabinets. Finally, either in 1945 or 1946, the International Detrola Corporation acquired through merger almost all of the outstanding stock of the Rohr Aircraft Corporation, a manufacturer of aircraft components.

On August 8, 1946, the plant and equipment of the Andrews Steel Corporation, located at Newport, Kentucky, were acquired for approximately \$1,665,000, together with all of the stock of the subsidiary Hardy-Burlingham Mining Company bituminous coal mine.⁵ In 1949, the name Newport Steel Corporation was assumed, and the Universal Cooler Co. of Canada, Ltd., the Elkhart, Indiana, plant known as the Aircraft Tool Division and the Rohr Aircraft Corporation—which had accounted for substantial portions of sales and profits during 1948 and 1949—were all disposed of.⁶ In August, 1950, the principal business of Newport was the production of steel ingots and the manufacturing of hot rolled steel and sheet steel.

Feldmann and members of his family personally owned approximately 85 percent of the stock of Strong, Carlisle & Hammond Company, which, as indicated above, had been acquired in 1942.⁷ In addition, Feldmann owned 60 percent—and his wife and three daughters each 10 percent—of the stock of Henney Motor Co., Inc.⁸

⁵ See Finding of Fact 19, Perlman v. Feldmann, 154 F. Supp. 436, 438; Cf. Defendants' Brief, *supra* note 2, at 96b-97b.

Q. What did Newport pay for those facilities, if you know? A. The inventory and the assets, including the stock of the Hardy-Burlingham Mining Company was about \$3,700,000 some odd thousand dollars. (Charles Russell Feldmann—For Defendants—Direct.)

⁶ The Universal Cooler Division, which had been planned to be sold prior to August 31, 1950, was actually sold on October 31, 1950.

⁷ Feldmann was Chairman of the Board of Strong, Carlisle & Hammond Company from 1942 to 1956 and sold his interest in the latter year.

⁸ Feldmann testified, "In 1946, latter part of 1946, I acquired 100% of the Henney Motor Company of Freeport, Illinois." Defendants' Brief, at 95b. In addition, the *Who's Who* entry indicates "purchased, reorganized and sold Winton Engine Co., Henney Motor Co., Victor-Penninsular Co., 1928." Finally, a story in the column "Market Place" in the *New York Times*, December 7, 1966, at 66, col. 8 noted that "Feldmann's . . . built more than 120 . . . battery-powered cars since 1960 . . . under the Henney Kilowatt emblem, and 58 utilities, perhaps hopeful of a runaway market someday, bought the cars for demonstration purposes."

(iii)

Newport commenced negotiations with Follansbee Steel Corporation in May, 1950, looking toward a merger of the two companies.⁹ The man who initiated,¹⁰ conducted, and was present at these negotiations, was Harold Ruttenberg, a steel broker of Pittsburgh, Pennsylvania.¹¹ Ruttenberg began to engage in general brokerages of businesses in January, 1949. From June, 1946, to January, 1949, he had been Vice-President of the Portsmouth Steel Corporation; for the ten years preceding 1946, he had occupied the position of Research Director of the United Steel Workers of America, except for a few years during World War II when he was Assistant Director of the Steel Division, War Production Board.¹²

In steel manufacturing, a cold rolled sheet has a finer finish and a lighter gauge than a hot rolled sheet and is used principally for more difficult work. Newport had no cold rolling facilities, which Follansbee possessed. Consequently, in the summer of 1950, if such facilities could have been obtained at a price and under terms which were advantageous to Newport, it might have been desirable—as Feldmann understood—for Newport to install cold rolling facilities in order to give Newport a more fully integrated operation.¹³

On June 26, 1950, the Korean War commenced.¹⁴ Feldmann testified as follows concerning a lease being negotiated with the United States Government on Newport's Detroit plant early in August of 1950:

We negotiated a lease calling for the payment of \$191,000 which was to be called a restoration fee, because the plant

⁹ Finding of Fact 47, *Perlman v. Feldmann*, 129 F. Supp. 162, 170 (D. Conn. 1952).

¹⁰ See Appendix to Brief for Plaintiffs-Appellants at 105a, *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955) [hereinafter referred to as Plaintiffs' Brief]:

Q. Who initiated or how were the merger negotiations initiated?—that is with Follansbee—A. There was a broker by the name of Harold Ruttenberg of Pittsburgh who initiated the contact between Mark Follansbee and myself. (Excerpts from Deposition of Charles Russell Feldmann).

¹¹ See Transcript of Record at 47, *Birnbaum v. Newport Steel Corporation*, 193 F.2d 461 (2d Cir. 1952) [hereinafter referred to as *Birnbaum Record*]:

Harold Ruttenberg is a steel broker of Pittsburgh, Pa. Ruttenberg was the person who conducted and was present at the negotiations between Feldmann on behalf of Newport and the representatives of Follansbee Steel Corporation. (Affidavit of Nathan B. Kogan, Attorney for Plaintiffs).

¹² See Plaintiffs' Brief, *supra* note 10, at 126a (Excerpts from Deposition of Harold J. Ruttenberg—for Plaintiffs—Direct).

¹³ Findings of Fact 45-47, *Perlman v. Feldmann*, 129 F. Supp. 162, 169-70.

¹⁴ Finding of Fact 42, *Perlman v. Feldmann*, 154 F. Supp. 436, 442 (D. Conn. 1957).

had certain equipment, electronic equipment and testing equipment and other equipment that was built into the plant. With the Korean War on, we might have been called upon in those facilities to manufacture some of the same type of equipment we made during World War II. In that plant we manufactured 70% of all of the land mine detectors that were used in World War II. I did not want to disturb those facilities and then get the building back at the end of a lease should they not exercise their option to purchase them, and have them destroy these facilities.¹⁵

In the merger negotiations, Follansbee would not consider an exchange basis less favorable than $1\frac{3}{4}$ shares of Newport for one share of Follansbee. Feldmann stated that a merger on the basis of $1\frac{3}{4}$ to one would not be in the best interests of Newport and all its stockholders, and took the position that a fair and proper exchange ratio should be $1\frac{1}{2}$ to one. Ruttenberg agreed that Feldmann's position was a reasonable one,¹⁶ though he tried to influence Feldmann to consider the Follansbee suggestion by pointing out that Feldmann would personally profit substantially

¹⁵ Defendants' Brief, *supra* note 2, at 128b-129b (Charles Russell Feldmann—For Defendants—Direct). Cf. N.Y. Times, July 3, 1966, note 2, *supra*:

C. Russell Feldmann, chairman and president of the National Union Electric Corporation, . . . explained that business was especially good in the Advanced Science division, which makes special fuses for hand grenades and other weapons, and the Eureka Williams Company, one of the largest makers of vacuum cleaners and other home care products. "We're building a little better 'mousetrap' there and are getting a bigger share of the business," he noted with a grin. . . .

In keeping with the interties between most of his ventures, Mr. Feldmann came into the vacuum cleaner business through the Detrola Corporation, which during World War II manufactured land mine detectors, or sweepers as they are called. Thus, when he became chief executive of National Union, it was only fitting that he work out the acquisition of the Eureka Williams Corporation, a famous name in the business for more than 50 years.

¹⁶ See Defendants' Brief, *supra* note 2, at 40b:

Q. But you did think Feldmann was reasonable in holding out for $1\frac{1}{2}$ for 1. A. Yes, because Federal Stamping and Enameling is, in my judgment and only my judgment, over evaluated on Follansbee's books. (Excerpts from Deposition of Harold J. Ruttenberg).

Cf. Defendants' Brief, *supra* note 2, at 130b:

Q. Who was the largest shareholder listed on [Follansbee's] proxy statement? A. As I recall, a Mr. Christman, who was about 84 years old or 86 years old and who was formerly chairman and president of their subsidiary known as the Federal Enameling and Stamping Company.

And when they—Follansbee—acquired it, he became chairman of the board of Follansbee, and as I recall the deal, they paid so much cash and so many shares of stock, and that is how he became the largest stockholder of Follansbee. (Charles Russell Feldmann—For Defendants—Direct).

thereby.¹⁷ Follansbee never made a firm offer of merger on any basis.¹⁸ On July 12, 1950, Follansbee and Newport mutually agreed to suspend the merger negotiations,¹⁹ and on July 28, 1950, Newport's Board of Directors unanimously approved the suspension of the negotiations for an indefinite period.²⁰

On August 3, 1950, a letter signed by Feldmann as President and containing the following paragraph was sent to all stockholders of Newport Steel Corporation:

Certain negotiations of an exploratory nature have been conducted, looking to a possible merger with Follansbee Steel Corporation. Because of the uncertain international situation, it is not now known what, if any, governmental restrictions may be imposed upon the manufacture and sale of steel. The Board of Directors have therefore decided that all such negotiations be suspended for an indefinite period.²¹

¹⁷ See Defendants' Brief, *supra* note 2, at 39b:

Q. Did you give Mr. Feldmann figures from which he could see the gain in market price that he would have on his own shares if a merger with Follansbee were concluded on the basis suggested by Follansbee? A. Yes.

Q. How much paper profit would he have made if he had agreed to the merger on the basis suggested by Mr. Follansbee? A. \$712,000. (Excerpts from Deposition of Harold J. Rutenberg).

¹⁸ See Defendants' Brief, *supra* note 2, at 35b:

Q. I should like to ask you, first, whether Follansbee Steel Corporation ever made an offer of merger to Newport Steel Corporation? A. We did not.

Q. Did Mr. Feldmann ever reject an offer of merger made by Follansbee Steel Corporation? A. We did not make an offer of merger. (Excerpts from Deposition of Marcus A. Follansbee).

¹⁹ See Defendants' Brief, *supra* note 2, at 35b:

Q. Was Mr. Feldmann the one who broke off merger negotiations? A. I think they were suspended mutually.

Q. Was the suspension in August of 1950? A. This suspension was on July 12, 1950.

See also Plaintiffs' Brief, *supra* note 10, at 114a:

A. I telephoned to him on July 12.

Q. What was the substance of your telephone conversation? A. I told him that this was the position that the board took, that the board was willing and anxious that we might continue negotiations with them. He said, "Well, that is fine. Let's continue to exchange balance sheets and profit and loss statements and maybe at some later date you will initiate or I may initiate some further discussions."

Q. What did you say? A. I said I was perfectly willing to leave it that way. (Excerpts from Deposition of Marcus A. Follansbee).

²⁰ For the material in this paragraph, see Finding of Fact 47, *Perlman v. Feldmann*, 129 F. Supp. 162, 170.

²¹ *Birnbaum Record*, *supra* note 11, at 20, 21. See also Finding of Fact 49, *Perlman v. Feldmann*, 129 F. Supp. 162, 170:

With the outbreak of the Korean War, there was a possibility that the Government might advance the money to Newport to put in cold rolling facilities on its own property and give Newport priorities to expedite the construction, as was done in World War II

But cf. Defendants' Brief, *supra* note 2, at 35b-36b, 211b:

During the late spring and early summer of 1950, Feldmann received numerous inquiries from persons interested in a possible purchase of his stock interest in Newport. One such inquiry, in June or July of 1950, was from a Mr. Barney Hokin, the president of International Rolling Mill Products Co., who asked if Feldmann would take \$20 a share for his stock. Another inquiry was from Ruttenberg, who on June 6, 1950, inquired whether Feldmann would accept \$10 a share.²² Feldmann testified that, although numerous calls were received by him after the commencement of the Korean War,²³ they had no influence on his decision to terminate the Follansbee negotiations.²⁴

On August 8, 1950, Sidney Coe of Irving Trust Company called Feldmann on behalf of William J. Mericka. Mericka had previously been substantially interested in Empire Steel Company. He was president of William J. Mericka & Co., investment securities dealers in Cleveland, and was chairman of the Executive Committee of the Bingham-Herbrand Corporation. The latter corporation was an "end user" of steel, *i.e.*, a company requiring steel for the manufacture of its products.²⁵

On August 9, Feldmann and William Alfs, a Vice-President of Newport and Feldmann's personal counsel, met with Mericka and Frank Cobourn in Detroit. Cobourn was a partner in a Toledo law firm and counsel for A.P. Parts Corp., an end user of steel.

Q. At the meeting of July 5 and 6 or at the meeting of June 27, Mr. Feldmann did not say anything along the line that because of the Korean incident he might wish to withdraw from the merger negotiations? A. No, we discussed the Korean situation and what possible effect it might have on both of us, but there wasn't any suggestion that we discontinue our discussions. (Excerpts from Deposition of Marcus A. Follansbee).

Q. Now, isn't it also a fact that the outbreak of the Korean incident was part of your calculations in deciding to suspend the Follansbee negotiations?

A. That was one of the reasons, yes. (Charles Russell Feldmann—For Defendants—Cross).

²² For the material thus far in this paragraph, see Finding of Fact 50, Perlman v. Feldmann, 129 F. Supp. 162, 170.

²³ Defendants' Brief, *supra* note 2, at 211b:

Q. All right, sir. Now, is it a fact that sometime after the outbreak of the Korean episode, Mr. Feldmann, you were deluged with requests of people who wanted to buy your shares? A. From time to time I had several inquiries. And I think perhaps the Korean incident brought more of them.

Q. Is it true to say that after Korea, sometime around July perhaps and early August you received numerous calls from brokers? A. Yes, sir. (Charles Russell Feldmann—For Defendants—Cross).

²⁴ Defendants' Brief, *supra* note 2, at 212b:

Q. Now did all of these inquiries that you were getting over the phone from brokers and other people, have anything to do with your decision to drop the Follansbee negotiations at that point? A. Absolutely not. (Charles Russell Feldmann—For Defendants—Cross).

²⁵ Finding of Fact 51, Perlman v. Feldmann, 129 F. Supp. 162, 170.

Mericka told Feldmann that he represented a group of end users of steel which might be interested in acquiring all of Feldmann's holdings in Newport Steel. Among members of the group were Gibson Refrigerator Co. and Bingham-Herbrand. Feldmann indicated that he might consider selling to such a group and said that he would not consider less than \$22 per share.²⁶

On August 9, 1950, the price of Newport's common stock was quoted in the over-the-counter market at 8¼ bid, 9 asked. Feldmann stated, however, that he thought the true value of the stock was much higher than that.²⁷ He talked again with representatives of the purchasing group on August 10, August 14, and August 24, 1950.²⁸

Mericka inspected the Newport plant on August 16 and returned on August 22 with other members of the purchasing group, as well as with Mr. James H. Hill, a top-flight operating man in the steel industry. All were much impressed by Newport's steel facilities.²⁹

On August 24, Feldmann, in Chicago for a meeting with Cobourn and Mericka, first went to two banks in order to inquire about Frank Gibson, Charles Gibson, and Gibson Refrigerator Co. Both banks issued very favorable reports about them. At the Ambassador East Hotel, where Alfs, Cobourn and Mericka were waiting, Mericka told Feldmann that he and Hill had both been very impressed by Newport, but that payment for the minimum number of shares that Feldmann was willing to sell would require expansion of the purchasing group. While the group had not yet been finally defined, Maytag Washing Machine Co. and Hudson Motor Car Co. were designated as additional members, and Feldmann was told that the group would be composed only of responsible companies who were end users of steel. Mericka offered \$18 per share for approximately 400,000 shares on the basis of a short-term option for half the stock and a thirty- to sixty-day option for the other half. Feldmann refused the offer. Cobourn then reported back to other members of the purchasing group while Mericka remained with Feldmann. Mericka, after talking with Cobourn on the telephone, offered Feldmann \$20 per share. Feldmann accepted this offer.³⁰

²⁶ Finding of Fact 52, *Perlman v. Feldmann*, 129 F. Supp. 162, 170-71.

²⁷ Finding of Fact 54, *Perlman v. Feldmann*, 129 F. Supp. 162, 171.

²⁸ Finding of Fact 55, *Perlman v. Feldmann*, 129 F. Supp. 162, 171.

²⁹ Finding of Fact 59, *Perlman v. Feldmann*, 129 F. Supp. 162, 171.

³⁰ Finding of Fact 63, *Perlman v. Feldmann*, 129 F. Supp. 162, 172.

Alfs then wrote out the following option in longhand, which Feldmann signed:

August 24, 1950

William Mericka:

For and in consideration of \$100, receipt of which is acknowledged, I agree to sell to you 200,000 shares of Newport Steel Corporation for \$4,000,000—at any time on or before August 31, 1950.

If you exercise this option on or before Sept. 1, 1950, on the terms above set forth, I will give you at that time an option to buy an additional number of shares of Newport Steel Corporation, not less than 175,000 shares nor more than 200,000 shares at \$20. per share, until 12:00 noon E.S.T. Nov. 1, 1950.

If you exercise the option to buy the shares (minimum 175,000, maximum 200,000) on or before Nov. 1, 1950, I will deliver to you, at the time you exercise the option, the resignation of all the members of the Board of Directors of Newport Steel Corpn.

(Signed) C. Russell Feldmann³¹

On August 29, 1950, the purchasing group organized a Delaware corporation, Wilport Company ["Wilport"], and Mericka assigned the option to it. Between August 24 and August 30, 1950, the purchasing group was expanded to comprise sixteen members, all of them end users of steel. The group members paid an aggregate of \$8,200,000 to Wilport to enable it to exercise the option, and received in return stocks and notes of Wilport.³²

On August 31, 1950, Feldmann went to Chicago, Illinois, and at that time Wilport exercised the option. Feldmann delivered to the Continental Illinois Bank 398,927 shares of Newport stock and Continental delivered to Feldmann, unconditionally, checks for \$7,978,540 in payment of the stock at \$20 per share, and the sale was completed.³³

As of August 31, 1950, the 343,375 shares owned or controlled, directly and/or indirectly by Feldmann and members of his family, were apportioned as follows:³⁴

Norman S. Feldmann.....	1,000
Raymond D. Feldmann.....	1,050
Charlotte M. Feldmann.....	2,000

³¹ Finding of Fact 65, *Perlman v. Feldmann*, 129 F. Supp. 162, 172.

³² Finding of Fact 67, *Perlman v. Feldmann*, 129 F. Supp. 162, 173.

³³ Finding of Fact 70, *Perlman v. Feldmann*, 129 F. Supp. 162, 173.

³⁴ Finding of Fact 7, *Perlman v. Feldmann*, 129 F. Supp. 162, 164.

John C. Vega.....	600
Josephine V. Vega.....	600
Barbara Jane Feldmann.....	7,800
Carolyn F. Otto.....	7,300
John F. Otto.....	2,200
Phyllis F. McKee.....	7,300
John V. McKee, Jr.....	2,525
Strong, Carlisle & Hammond Co. ³⁵	261,000
Henney Motor Co., Inc. ³⁶	50,000
TOTAL	<u>343,375</u>

In addition to John V. McKee, Jr., Feldmann's son-in-law, the other Newport directors, with the exception of Feldmann himself, participated in the stock sale to Wilport by selling the following numbers of shares at \$20 per share:³⁷

D. M. Shaeffer.....	5,000
F. L. Taylor.....	2,600
A. F. Lorenzen.....	1,010

The balance was made up by the shares of numerous friends and associates of Feldmann.³⁸ In addition, F. L. Taylor sold some

³⁵ See, in this connection, note 7 *supra*. See also Defendants' Brief, *supra* note 2, at 162b:

Q. Now, had you previously aranged for certain employees of Newport Steel or Strong, Carlisle and Hammond to buy shares of Newport Steel? A. Yes.

Q. Had you loaned them the money or arranged for loans for them with which to buy shares? A. Yes.

Q. And did you consider yourself under an obligation to allow these employees to sell shares if you sold? A. Yes, sir.

Q. Did you permit these employees to sell their shares at \$20? A. Yes.

Q. Did they sell all their shares? A. Yes. (Charles Russell Feldmann—For Defendants—Direct).

³⁶ See, in this connection, note 8 *supra*. See also *Birnbaum Record*, *supra* note 11, at 54:

Henney Motor Company, Inc. is a personal holding company of C. Russell Feldmann in which defendant Feldmann owns all the stock. It was incorporated in New York on November 22, 1933 as C. Russell Feldmann & Co., Inc. and the name was changed to Henney Motor Company, Inc. on May 22, 1946. The Certificate of Incorporation of Henney Motor Company, Inc. provides that the office of the corporation shall be located in the City, County and State of New York. (Affidavit of Nahum Birnbaum).

³⁷ Finding of Fact 72, *Perlman v. Feldmann*, 129 F. Supp. 162, 173.

³⁸ Finding of Fact 71, *Perlman v. Feldmann*, 129 F. Supp. 162, 173. See also *Birnbaum Record*, *supra* note 11, at 54:

Defendant Feldmann owned and controlled the stock of Newport which he sold to Wilport through Henney Motor Company, Inc., Charlotte E. Feldmann, Barbara Jane Feldmann, Joseph V. McKee, Jr., Phyllis M. McKee, Carolyn Otto, D. M. Schaeffer, Lucille Shaeffer and R.J. Nixon. (Affidavit of Nahum Birnbaum).

Lucille Shaeffer is the wife of D.M. Shaeffer, and R.J. Nixon is listed as Treasurer and Controller of Newport Steel Corporation in *Moody's Industrial Manual* 780 (1949).

of the Newport shares owned by him to members of the Feldmann family,³⁹ as did others of the friends and associates, some of whose shares Feldmann had delivered to the Continental Illinois Bank.⁴⁰

After the consummation of the sale, Feldmann convened a special meeting of Newport's board of directors. Three of Feldmann's co-directors—McKee, Lorenzen, and Sheaffer—were present. Feldmann had with him the signed resignation of Newport's fifth director, Taylor. Immediately prior to the meeting,

³⁹ See Defendants' Brief, *supra*, note 2, at 160b-61b:

Q. Did you have conversations with Mr. Taylor with respect to the purchase of any of his stock? A. Yes, sir.

Q. Would you tell us what those conversations were? A. Mr. Taylor was a director of the corporation and one who I would see probably every other day, and some weeks every day, and he lives in Greenwich, Connecticut. We commute together sometimes. And he said that whatever I wanted to do was entirely agreeable with him, but he wanted to sell all his other stock if I was selling all of mine. It made no difference to him how much he sold at \$20 or how much he sold at whatever was a fair price or whatever I wanted to do.

Q. Well, what was the substance of the arrangements that you made with Mr. Taylor? A. A portion of his holdings were sold at \$20 and the balance were sold to members of my family. I don't have the details in front of me.

Q. At what price? A. I think it was \$10 or \$11. I think it was \$10 a share. (Charles Russell Feldmann— For Defendants— Direct).

⁴⁰ See Defendants' Brief, *supra* note 2, at 159b-60b:

Q. Now, did you have any conversations with Adam Sarver? A. Yes, sir.

Q. Will you tell us who Mr. Sarver is, his relationship with Newport Steel and the substance of your conversation? A. Mr. Sarver is a gentleman about 84, 85 years old, a man worth about \$15,000,000. He was one of the founders of General Motors with W.C. Durant, and he was the founder of the Universal Cooler Company, a man whom I have known for many years.

Q. Well, what was the substance of your conversation with Mr. Sarver? A. I told Mr. Sarver—I can't remember the date, but it was sometime after the 24th, after I had executed the option, and I told him exactly what I had planned to do. And he was the second largest stockholder in the Newport Steel as a result of the merger of Universal Cooler into Newport Steel, and he said that whatever I wanted to do, that is what he wanted to do.

And I told him that I had made a commitment to sell 400,000 shares of stock, and I did not know exactly how many shares would be represented by my business associates and my family, and a few close friends and business associates, people with whom I have done business.

He said, "Well, whatever you want to do, Russ, is perfectly all right with me. It makes no difference to me, but I want to sell my stock if you sell yours."

Q. Did he say whether he wanted to sell all of his stock or part of his stock or some of his stock? A. He said, "However you arrange it." He said, "I want to sell all of my stock whether you buy it or who buys it, I want to sell all of my stock if you are selling all of yours."

Q. What did you say to Mr. Sarver? What arrangements did you make with Mr. Sarver with respect to his holding of Newport Steel? A. I told Mr. Sarver, I asked Mr. Sarver if it would be agreeable to him if he were to sell 20 - 5,000 shares of stock at \$20 and members of my family would take another 27 or 2,300 shares at \$10 and the balance of the stock I would take at any price he wanted to sell it for.

He said he was coming to New York in two or three weeks, and he said, "When I get there I intend to visit with you as I always have" and he said

Feldmann was for the first time informed of the identity of the full slate of directors proposed by Wilport.⁴¹

After the meeting was convened, the directors of Newport successively resigned and, as each vacancy arose, the Board elected the new directors. Each of these directors was a director of Wilport.⁴²

At the meeting of Newport's board of directors on August 31, 1950, Feldmann also resigned in his capacity of chairman of the board and president of Newport.⁴³

Under date of September 14, 1950, Frank S. Gibson, as president of Newport, sent a letter describing these events to the stockholders.⁴⁴ In addition, the following steps were taken in connection with Newport's contracts with the City, County, and State of New York:

"On September 20, 1950, at a regular meeting held in Newport, Kentucky, the Board of Directors of Newport Steel Corporation amended Section 3 of Article IV of the by-laws of said Corporation to provide that regular meetings of the Board of Directors should be held at Newport, Kentucky, rather than at 4606 Chrysler Building, New York City, New York.^[45] In addition, the fol-

"We will talk about it at that time." (Charles Russell Feldmann—For Defendants—Direct).

See also Defendants' Brief, *supra* note 2, at 161b-62b:

Q. Now, did you have any conversations with Mr. McNeil? A. Yes, sir.

Q. Tell us what the conversations were and who Mr McNeil was. A. Mr. McNeil was President of the Universal Cooler Company at the time of the merger, and after the merger he became General Manager of the Universal Cooler Division of Newport Steel Corporation. At the time of the merger Mr. McNeil wanted to own more stock than he would have after the merger. I loaned Mr. McNeil \$85,000 to buy some of his stock. I arranged the loan with one of my banks and guaranteed it personally. The loan continued for about a year, a year and a half, I don't recall. But it was some period of time.

I told Mr. McNeil—well, in the meantime Mr. McNeil, by mutual agreement, he resigned as director in about 1947 or '48, and also as General Manager of the division, and he bought a small business for himself.

Q. What was the substance of your conversations, if there were any? A. I told him exactly what I was doing, and I told him I was selling my stock, and at the price I was selling it at. And he said, "Well, Russell, anything you want to do. If you want to take me in or take me out for part of my stock at \$20 and buy the balance of my stock," he said, "that is entirely agreeable with me."

Q. What were the arrangements, if any, that you made with Mr. McNeil?

A. Mr. McNeil—I had forgotten the number of shares that he was taking out at \$20 and the balance was bought from him at \$10 a share. (Charles Russell Feldmann—For Defendants—Direct).

⁴¹ Finding of Fact 74, *Perlman v. Feldmann*, 129 F. Supp. 162, 173-74. The slate consisted of Frank Gibson, Mericka, Cobourn, Paxton, and Mitchell. Feldmann knew that Paxton was a member of a well-known, reputable, Chicago law firm and general counsel to Gibson Refrigerator Co., and Alfs had previously spoken favorably of him. *Id.*

⁴² Findings of Fact 74, 75, *Perlman v. Feldmann*, 129 F. Supp. 162, 174.

⁴³ Finding of Fact 76, *Perlman v. Feldmann*, 129 F. Supp. 162, 174.

⁴⁴ Finding of Fact 121, *Perlman v. Feldmann*, 129 F. Supp. 162, 179.

⁴⁵ *See* note 65 *infra*.

lowing two resolutions were unanimously adopted by said Board of Directors at the same meeting:

RESOLVED, that the Treasurer, Mr. H.E. Hamilton be and he is authorized to dispose of the furniture and equipment of the corporation located in the New York office at the best price obtainable, not less, however, than \$3,000.00 in the aggregate.

RESOLVED, that the Treasurer, Mr. H.E. Hamilton, take such steps and execute and deliver such sub-leases, assignments, and other instruments as shall be necessary to sub-lease, assign or otherwise dispose of the office space in the Chrysler Building, New York City, New York, now under lease to the corporation; to the end that the corporation may be relieved of the obligation of continuing to maintain such space after September 30, 1950. . . .

“In the latter part of September, 1950, the corporation closed out its account with Central Hanover Bank and Trust Company, New York City, New York, and the lease to the corporation of space in the Chrysler Building, 405 Lexington Avenue, New York, New York, Rooms 4606-11, was terminated with the lessor’s consent, and on September 30, 1950, this space was leased to Strong, Carlisle & Hammond Company. . . .

“On or about September 30, 1950, the name of Newport Steel Corporation was removed from the door of Room 4606, and from the Chrysler Building Directory. . . .

“On or about October 4, 1950, the office equipment, located in the aforesaid space, and owned by the corporation, was disposed of and sold to Strong, Carlisle & Hammond Company. . . .

“On or about October 5, 1950, the New York Telephone Company was directed to and did remove the name of the corporation from its listing at the above address and did transfer Newport Steel Corporation’s former New York City telephone number, Murray Hill 9-4392, to Strong, Carlisle & Hammond Company.”⁴⁶

Under date of November 6, 1950, Ruttenberg wrote to the officers and directors of Newport Steel Corporation, suggesting that negotiations with Follansbee be re-opened,⁴⁷ a suggestion

⁴⁶ *Birnbaum* Record, *supra* note 11, at 36-38 (Affidavit of Frank M. Cobourn).

⁴⁷ Plaintiffs’ Brief, *supra* note 10, at 178a-79a (Plaintiffs’ Exhibit 38):

Dear Sirs:

It has been over two months since you purchased control of the Newport Steel Corporation and became the new directors. When your predecessor directors resigned there was pending before them a merger proposal from the Follansbee Steel Corporation. Two of your directors, Messrs. W.J. Mericka and F.M. Cobourn, were prompt in exploring this proposal by meeting for

that he testified was rejected on the same grounds that had prevented the earlier discussions from reaching a successful conclusion.⁴⁸

Under date of January 19, 1951, a proxy statement was sent to Newport's shareholders, informing them that the Board of Directors consisted of Frank S. Gibson, Jr., Frank M. Cobourn, William J. Mericka, Bernard A. Mitchell, and George H. Roderick.⁴⁹

The statement also noted that:

Wilport Company is a corporation owned by a group of manufacturing companies, all of whom use steel in their own manufacturing operations. Beginning with small quantities in the month of October, 1950, and increasing to substantial tonnages in later months as Newport Steel Corporation was able to supply steel to the manufacturing companies who are stockholders of Wilport Company, sales of steel to such companies have been made. Such sales have been at the established mill prices of Newport Steel Corporation, and on its regular terms of payments.⁵⁰

At the annual meeting of Newport's shareholders, held on February 19, 1951, the following resolutions were adopted:

Resolved, by the shareholders of Newport Steel Corporation, that the action of the officers and directors in authorizing and approving the sale and delivery from time to time of

half a day on September thirteenth last with the principal officers and directors of Follansbee Steel, following which Mr. Mericka made an inspection tour of Follansbee's rolling mill and fabricating facilities in Follansbee, West Virginia on October nineteenth last. The purpose of this communication is to urge you to enter into serious discussions with Follansbee Steel, such as your predecessors held on July fifth and sixth, 1950, and before and after these dates, with a view toward effecting a merger between Newport Steel and Follansbee Steel.

No doubt by now you are fairly well acquainted with the Newport Steel properties at Newport, Kentucky. As they are presently constituted, they are non-competitive, and will be the first to suffer from any drop in the demand for steel below capacity levels. . . .

See also Defendants' Brief, *supra* note 2, at 37b:

Q. I am not now referring to the negotiations which took place under Mr. Feldmann's regime, but to your latest suggestion to Newport made to the new Newport management. A. Well, the new Newport management objected to consolidation around the same fundamental point that kept the previous discussions from coming to a fruitful conclusion, namely, the high value at which Follansbee Steel Corporation has its subsidiary, the Federal Enamel and Stamping Company on its books. (Excerpts from Deposition of Harold J. Ruttenberg).

⁴⁸ *Id.*

⁴⁹ George H. Roderick was Vice-President and director of American Seating Co., of Grand Rapids, Michigan, one of Wilport's contributors and stockholders. See Plaintiffs' Brief, *supra* note 10, at 198a (Consolidated Amended Complaint).

⁵⁰ Finding of Fact 123, *Perlman v. Feldmann*, 129 F. Supp. 162, 180.

steel produced by this corporation, at its then prevailing mill prices, to stockholders of Wilport Company, be, and the same hereby is ratified, approved and confirmed.

Resolved, by the shareholders of Newport Steel Corporation, that all the acts of officers and directors of this corporation since the date of the last annual shareholders' meeting held March 27, 1950, be, and the same hereby are ratified, approved and confirmed.⁵¹

(iv)

In an agreement with Merritt-Chapman & Scott Corporation (controlled by Louis E. Wolfson), dated December 18, 1953, Wilport agreed to transfer its controlling interest in Newport to Merritt-Chapman & Scott by an exchange of one share of Merritt-Chapman & Scott common stock for each 2.1 shares of Newport common stock. The transfer was contingent on Merritt-Chapman & Scott making a general offer on the same basis to all Newport shareholders and acceptance of that offer by holders of $66\frac{2}{3}$ percent of Newport's outstanding shares. The price of Merritt-Chapman & Scott common stock at the date of the offer was approximately \$22 per share, thereby yielding Wilport and other Newport shareholders about \$10.50 per share. Early in 1954, Merritt-Chapman & Scott succeeded in acquiring 94.7 percent of Newport's stock on the basis of this offer.⁵²

"There was a time, early in the [1950's], when Louis Elwood Wolfson looked to many like the prototype of the new kind of self-made multimillionaire who was turning up all over the business landscape. He showed a nose for capital gains, and brains and daring in putting together deals, so that even in an era of high personal-income taxes he was able to accumulate huge fortunes."⁵³

The basis for Wolfson's success was a series of timely corporate acquisitions. In an article entitled "The Man Who Wants Montgomery Ward," *Business Week* magazine summarized the ideology that underlay the campaigns for shareholder approval required by many of those acquisitions:

⁵¹ Finding of Fact 125, *Perlman v. Feldmann*, 129 F. Supp. 162, 180-81.

⁵² For the material in this paragraph, see SEC PROSPECTUS OF MERRITT-CHAPMAN & SCOTT CORPORATION, dated January 27, 1954; MOODY'S INDUSTRIAL MANUAL 2646 (1955); 1953 and 1954 ANNUAL REPORTS OF MERRITT-CHAPMAN & SCOTT CORPORATION at 19 and 24, respectively.

⁵³ Hammer, *Why Things Went Sour for Louis Wolfson*, 64 FORTUNE 132 (Sept., 1961).

Wolfson vows he wants Ward mostly because it offers him his best chance to complete a major task he has set for himself: to assure that the American stockholder gets the kind of treatment from American management that Wolfson thinks he should have.

Wolfson thinks—as do some others—that it's a disgrace that there are only 6.5-million stockholders in the U.S. He's convinced this is due primarily to a profound lack of public confidence in the way U.S. management handles the investor's money.

He doesn't like stock option plans, and he thinks executive pensions are much less tightly controlled than they should be. He thinks every officer ought to be required to put at least a year's pay in his company's stock—at the stock's market price, not at a cut rate. He believes that the best thing management can do with earnings is to disburse them to stockholders "after prudent lay-aside for operations, reserve and development."⁵⁴

By July 18, 1957—the dateline of the *New York Times* story quoted in part (i), *supra*—Newport Steel Corporation was known as Newcorp, Inc.⁵⁵

B. The Proceedings

(i)

The 1950 Newport Annual Report sent to its stockholders under date of January 19, 1951, included the following paragraph:

Suits by Stockholders:

Several civil actions have been filed and are pending, which are derivative actions brought by stockholders on behalf of the Corporation. None of them seeks recovery of money from the Corporation. Some of them seek to recover for the Corporation a part of the price realized by the former President and other stockholders from the sale of certain Common Stock of the Corporation.⁵⁶

The conclusions of law arrived at by the District Court on remand (in the opinion reported in the *New York Times* story quoted in part A(i), *supra*), are as follows:

⁵⁴ BUS. WEEK 172, 174 (Oct. 2, 1954).

⁵⁵ Finding of Fact 2, *Perlman v. Feldmann*, 154 F. Supp. 436.

⁵⁶ Finding of Fact 124, *Perlman v. Feldmann*, 129 F. Supp. 162, 180.

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⁵⁵ Finding of Fact 2, *Perlman v. Feldmann*, 154 F. Supp. 436.

⁵⁶ Finding of Fact 124, *Perlman v. Feldmann*, 129 F. Supp. 162, 180.

“The difference between \$14.67 and the \$20 per share received by the defendants constituted a premium or bonus paid by Wilport Company for control over Newport’s output of steel.

“The bonuses or premiums of \$5.33 per share for the 398,927 shares sold by the individual defendants (*i.e.*, those other than Newport Steel Corporation, now Newcorp, Inc) to the Wilport Company total \$2,126,280.91. The Wilport Company shares, which are barred by the judgment of the Court of Appeals from recovery in this proceedings, constituted 36.99% of the outstanding shares of Newport. This percentage of the \$2,126,280.91 amounts to \$786,511.29 which, deducted from the \$2,126,280.91, leaves \$1,339,769.62 due by the individual defendants to the plaintiffs and those whom they represent, *i.e.*, the present holders of the shares of Newport outstanding on August 31, 1950, other than the present holders of any of the shares then transferred to the Wilport Company; the plaintiffs and such qualified present holders of shares will take in proportion to the number of shares each holds.

“Judgment may enter for the plaintiffs and those whom they represent to recover from the defendants the sum of \$1,339,769.62 with interest at 6% per annum from August 31, 1950, and their costs.

“An order will subsequently issue appointing a special master to determine who, in accordance with the terms of the judgment to be entered on this Memorandum, are the particular persons which or whom the plaintiffs represent and the portion of the judgment to which each is entitled.”⁵⁷

(ii)

On or about September 20, 1950, Howard Cagle, a stockholder, sent the following letter to Frank S. Gibson, Jr., President of Newport:

Dear Mr. Gibson:

For more time than I care to remember, I have owned 450 shares of stock in the Company which you recently became President of, now known as Newport Steel.

While I am glad to see that your attitude is to issue periodical reports (and I certainly had trouble getting any information out of Mr. Feldman [*sic*] there are still a number of things I would like to know more about. For instance:

⁵⁷ Perlman v. Feldmann, 154 F. Supp. 436, 446-47.

What did Feldman [*sic*] and his family get for his stock?

Would it have not been better if the Company had accepted the Follinsbee [*sic*] deal? (I understand I would have gotten around \$16 a share for my stock on that deal)

Is Feldman [*sic*] still connected with the Company?

Who and what is the Wilport Company?

Who are the owners?

Have any changes been made by your group in the operation of the steel plant?

What are the prospects for a dividend?

I am sorry to be taking up your valuable time this way, but I would appreciate it if you would give me the information asked for above.⁵⁸

On November 17, 1950, a complaint was filed in the United States District Court for the Southern District of New York on behalf of Nahum Birnbaum, Morris J. Lutterman and Hana D. Lutterman, co-partners, doing business under the firm name and style of Birnbaum & Co. (with offices at 60 Broad Street), suing

⁵⁸ Glenn G. Paxton, Secretary of Newport, sent the following reply, dated October 2, 1950, to Mr. Cagle:

Your letter of September 20th addressed to Mr. Frank S. Gibson, Jr., President, has been referred to me for reply. Some of your questions relate to matters in which the corporation is not involved. The others, I am glad to answer.

Mr. Feldmann is no longer connected with the corporation as an officer, director or employee. No drastic changes have been made in the operation of the steel plant during the past month, but prices were increased on September 8th; every reasonable effort is being made to increase production and to bring the operations of some of the steel making facilities more nearly to rated capacity; and consideration will be given to the problem of what can be done to make the steel plant more nearly competitive under normal conditions.

With respect to the "Follinsbee Deal" which you mentioned, I have no first-hand information on the subject but I note that in Mr. Feldmann's letter to stockholders dated August 3rd it was stated that negotiations had been discontinued. From what I have heard a possible merger had been discussed, which I assumed involved an exchange for stock. I doubt that the merger would have provided for the payment of any cash to stockholders of either Company, but this is merely an assumption since I do not know what the negotiations were. It seems quite doubtful that the merger of the two companies would have accomplished very much in the way of making the surviving company an integrated competitive producer.

In my opinion, dividends in the near future are unlikely. Heavy capital acquisition of new steel making facilities in recent years, the failure of the steel division during the first ten months of the current fiscal year to realize profits, and other factors have adversely affected the Company's working capital position. It seems clear that the payment of dividends will have to be postponed until the Company's capital position is improved.

See *Birnbaum Record*, *supra* note 11, at 25-27 (Exhibits C and D, annexed to Complaint).

on their own behalf and on behalf of all similarly situated stockholders of Newport Steel Corporation, and on behalf of Newport Steel Corporation. The opinion of the District Court summarized the complaint as follows:

“Two causes of action are alleged, one a derivative action brought on behalf of the Newport Steel Corporation, the other a class action brought by plaintiffs as representatives of all the stockholders of Newport similarly situated. Jurisdiction is alleged to exist in this court by virtue of §§ 27 and 29 of the Securities Exchange Act, 15 U.S.C.A. §§ 78aa and 78cc.

“In substance, the complaint alleges that defendant Feldmann, who was president and chairman of the board of directors of Newport, a manufacturer of steel, controlled Newport through ownership or control of 40% of its stock; that defendants Stamm,⁵⁹ Rheim,⁶⁰ Rohr,⁶¹ Lorenzen, Sheaffer and Ballantyne,⁶² as directors of Newport,⁶³ acted under the control of Feldmann, and that in August 1950, defendant Feldmann rejected an offer of Follansbee Steel for a merger on terms profitable to Newport. Feldmann rejected the Follansbee offer, the complaint alleges, because he intended to sell his stock in Newport to defendant Wilport Company, at \$22 a share, twice the market value, thereby obtaining for himself an opportunity that should have accrued to the corporation. The excess, it is claimed, was paid for the control of Newport.

“It is further alleged that Feldmann violated Rule X-10B-5 when he reported by letter to Newport stockholders about the negotiations with Follansbee but failed to disclose his personal interest in its rejection. In addition, there are allegations that

⁵⁹ C.H. Stamm was listed as a director of Newport Steel Corporation and Vice-President and General Manager of the Newport Rolling Mill Division in *Moody's Industrial Manual* 780 (1949). *But see* note 63 *infra*; note 45 and accompanying text *supra*.

⁶⁰ J.E. Rheim was listed as a director of Newport Steel Corporation and Vice-President and General Manager of the Refrigeration and Radio Division in *Moody's Industrial Manual* 780 (1949). *But see* note 63 *infra*; note 45 and accompanying text *supra*.

⁶¹ F.H. Rohr was listed as a director of Newport Steel Corporation in *Moody's Industrial Manual* 780 (1949). *But see* note 63 *infra*; note 45 and accompanying text *supra*.

⁶² J. Ballantyne was listed as a director of Newport Steel Corporation in *Moody's Industrial Manual* 780 (1949). *See also* *Birnbaum Record*, *supra* note 11, at 40 (Affidavit of Frank M. Cobourn subscribed and sworn to January 12, 1951): “John Ballantyne is deceased.”

⁶³ The 1949 *Annual Report of Newport Steel Corporation For Year Ended October 31, 1949*, which contains a President's Letter to the Shareholders dated March 1, 1950, lists the Directors as C. Russell Feldmann, Chairman, A.F. Lorenzen, Joseph V. McKee, Jr., D.M. Sheaffer, and Frank L. Taylor. The Report also lists General Offices at 9th and Lowell Streets, Newport, Kentucky, and Executive Offices at 405 Lexington Avenue, New York 17, New York.

Feldmann and the other directors resigned pursuant to the terms of the sale to Wilport; and that Wilport, a corporation owned by ten large users of steel, was using, and intending to use, Newport as a "captive" subsidiary. Plaintiffs ask that all defendants, save Newport, be directed to account, that defendants Wilport, Gibson, Mericka, Mitchell, Cobourn and Paxton, directors and officers of Wilport, be enjoined from causing Newport to sell exclusively to Wilport; and that the sale of Feldmann's stock be declared void."⁶⁴

On January 10, 1951, defendant C. Russell Feldmann moved for judgment dismissing the complaint for failure to state a claim. On the same date, defendant Wilport made a similar motion, including as grounds lack of jurisdiction over its person⁶⁵ and improper venue. Defendant Newport's motion, made five days later, cited failure to state a claim and improper venue as grounds for dismissal. On May 29, 1951, Hon. Samuel H. Kaufman granted the motions on the following ground:

"Even if it be assumed, without deciding, that the facts alleged amount to a fraud upon the minority stockholders of Newport, plaintiffs may not have their remedy in this court, since jurisdic-

⁶⁴ *Birnbaum v. Newport Steel Corp.*, 98 F. Supp. 506, 508 (S.D.N.Y. 1951).

Section 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78(j)(b), renders it unlawful, in interstate commerce or through the mails:

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5; 17 C.F.R. § 240.10b-5 (1942), makes it unlawful, in interstate commerce or through the mails:

(1) To employ any device, scheme, or artifice to defraud,
 (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
 (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

⁶⁵ See *Birnbaum* Record, *supra* note 11, at 33 (Affidavit of Glenn G. Paxton):

Deponent further says that Wilport Company is a corporation organized and existing under and by virtue of the laws of the State of Delaware; that said corporation was not at any time prior hereto and is not now found in the State of New York or in the Southern District of New York; that said corporation was not at any time prior hereto nor is it now an inhabitant of the State of New York or the Southern District of the State of New York; that said corporation has not at any time prior hereto nor does it now transact any business in the State of New York or in the Southern District of New York; and that said corporation has not at any time prior hereto performed nor is it now performing any act or transaction the State of New York or in the Southern District of New York.

See also note 45 and accompanying text *supra*.

tion in this case is not predicated upon diversity of citizenship, and plaintiffs have not shown a violation of § 10(b) and the Rule effectuating it, X-10B-5. . . .

. . . The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase. * * *

“The essence of the complaint in this case is that the sale by Feldmann of his Newport stock constituted a fraud on Newport’s minority stockholders, not that it was a fraud on the purchaser of the stock.”⁶⁶

On June 22, 1951, plaintiffs filed a notice of appeal. In addition to arguments on the question of whether Rule X-10B-5 should or should not apply, Newport and Wilport reiterated—in their briefs in the Court of Appeals—their argument concerning the question of venue: that a provision of federal law permitting a stockholder’s suit to “be prosecuted in any judicial district where the corporation might have sued the same defendants” was satisfied only if *all* of the defendants named in the complaint could be sued in the district in which the suit is brought. In support of its statutory construction argument, Newport cited (and reproduced in an Appendix) the unpublished opinion in the case of *Mernoff v. Ballantyne*,⁶⁷ which had been filed in the United States District Court for the District of Connecticut on May 31, 1951, and in which Newport’s motion to dismiss on the ground of improper venue was granted in an order dated July 13, 1951.

Hon. C.C. Hincks summarized the facts which formed the basis of his opinion in *Mernoff v. Ballantyne* as follows:

The defendant Newport Steel Corporation (hereinafter called Newport) the beneficiary, or allegedly injured, corporation in this stockholder’s derivative action, moves to dismiss on the grounds of improper venue. The complaint shows that the plaintiff is a citizen of New York and a stockholder in Newport; that Newport is an Indiana corporation; and that neither of the other two corporate defendants and none of the individual defendants are citizens or residents of New York. Further than this, the complaint does not specify as to the citizenship of the defendants. However, an affidavit submitted

⁶⁶ Birnbaum v. Newport Steel Corp., 98 F. Supp. 506, 508-09 (S.D.N.Y. 1951).

⁶⁷ Civil Action No. 3322 (D.Conn 1951).

by the Treasurer of Newport, not controverted by the plaintiff, shows that three, and three only, of the sixteen named individual defendants are residents of Connecticut, and that none of the three defendant corporations, including Newport, is incorporated in Connecticut or has been licensed to do business or is doing business in Connecticut. The only defendants thus far served with process are Feldmann, an individual who is a citizen of Connecticut, and Newport, the injured corporation.⁶⁸

In the Second Circuit Court of Appeals, however, a panel consisting of Augustus N. Hand (who wrote), Learned Hand (retired), and Chief Judge Thomas W. Swan affirmed the District Court judgment in *Birnbaum v. Newport Steel Corp.*, and followed its reasoning in an opinion which concluded that:

[S]ection 16(b) of the Acts of 1934, 15 U.S.C.A. § 78p(b), expressly gave the corporate issuer or its stockholders a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. The absence of a similar provision in Section 10(b) strengthens the conclusion that that section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller. Since the complaint failed to allege that any of the plaintiffs fell within either class, the judgment of the district court was correct and is accordingly affirmed.⁶⁹

A petition for writ of certiorari was filed in the Supreme Court of the United States on April 9, 1952. The petition stated that the Second Circuit decision was "in direct conflict with a decision of a District Court in the Third Circuit, *McManus v. Jessup & Moore Paper Co.*, Civil No. 8015 (E.D. Pa. 1948),"⁷⁰ and concluded that:

The decision of the Court below opens a great loophole through which corporate fiduciaries may defraud their minor-

⁶⁸ Brief for Appellee at 13, *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2nd Cir. 1952). See also *id.* at 9-10.

⁶⁹ *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 464 (2 Cir. 1952).

⁷⁰ Petitioners' Brief for Certiorari at 7, *Birnbaum v. Newport Steel Corp.*, 343 U.S. 956 (1952). See also *Birnbaum v. Newport Corp.*, 98 F. Supp. 506, 509 (S.D.N.Y. 1951):

With the exception of one case, decided without opinion [*McManus v. Jessup & Moore Paper Co.*, Civ. No. 8015 (E.D. Pa. 1948)], none of the authorities cited by plaintiffs support the proposition that Rule X-10B-5 applies to such conduct.

ity stockholders. Even if the common law were to provide adequate substantive remedies in a situation such as this, the jurisdictional problems which the Act was meant to avoid are insuperable in a state court action. The securities statutes, with their provisions for nation-wide service of process, were intended to protect scattered security holders who could not protect themselves because of the inadequacies of state court jurisdiction. This case is exactly the situation which the statute was meant to cure. The defendants herein are residents of states from Maine to California. . . . Newport is an Indiana corporation allegedly not presently doing business in New York. . . . Wilport is a Delaware corporation. . . . Feldmann lives in New York.⁷¹ . . . The other stockholders are scattered all over the country, and an over-the-counter market exists in Newport's shares It would be impossible to bring all necessary parties before a court and to obtain full determination of the allegations of the complaint, except pursuant to the statutory provisions of § 27 of the Securities Exchange Act, which provide for nation-wide service of process.

No such gap in the area of regulation was intended to exist by Congress. It is for this reason that § 10(b) was phrased as a "catch-all" provision intended to grant protection to the public and investors against all types of fraud. Neither § 10(B) nor Rule X-10B-5 should be bound by the strict construction given them by the Court below. . . .

Before the broadly remedial purpose of Congress to grant protection to the public and investors against all types of fraud is limited in accordance with the decision below, this Court should rule on the question. The issue herein is one of great public importance, since it will determine whether investors have any effective remedy against fraud by a fiduciary in connection with a purchase or sale of securities.⁷²

The petition was denied on May 26, 1952.⁷³

⁷¹ See *Birnbaum Record*, *supra* note 11, at 53, 54 (Affidavit of Nahum Birnbaum):

I am informed and believe that the only office maintained by defendant Feldmann for the transaction of business was and is in the Southern District of New York. The address, room number and telephone number of the Southern District offices of Newport Steel Corporation and defendant Feldmann were at all times mentioned in the complaint herein the same. Both were at 4606 Chrysler Building, 405 Lexington Avenue, Murray Hill 9-4392.

Charlotte E. Feldmann is the wife of C. Russell Feldmann and resides with him at the Hotel Pierre, Fifth Avenue and 61st Street in the Southern District of New York.

⁷² Petitioners' Brief for Certiorari at 11-12, *Birnbaum v. Newport Steel Corp.*, 343 U.S. 956 (1952).

⁷³ *Birnbaum v. Newport Steel Corp.*, 343 U.S. 956 (1952).

(iii)

On November 13, 1951, in the United States District Court for the District of Connecticut in New Haven, Conn., with Hon. Carroll C. Hincks, Chief Judge, serving as trial judge, trial began in the case of *Pertman v. Feldmann and Newport Steel Corp.* which had been filed on October 2, 1950.⁷⁴

A letter dated October 28, 1950, was sent by Glenn G. Paxton as Secretary of Newport Steel Corporation to lawyers representing a group of shareholders.⁷⁵ Paxton's letter responded in the following terms to the letter they had addressed to Newport Steel Corporation and certain members of its Board of Directors:

"You and your clients are evidently laboring under certain misapprehensions of fact, which we wish to correct. The owners of Wilport Company have not purchased, and have no intention of purchasing, steel from Newport at an inadequate price or at a price lower than the price asked by Newport and its competitors from other customers. Currently, Newport is asking and obtaining a higher price for its steel than is being charged by any comparable competitor, regardless of size, and it is the intention of the management to continue to establish prices at levels which will result in profitable operations. Incidentally, one of the first steps taken by the present management early in September, 1950, was to increase the prices of its steel products in practically all categories to the extent of \$10.00 per ton. Any notion which your clients may have that Newport has been or will be deprived of large profits from the sale of its production is simply not in accordance with the facts. . . .

"Contrary to the allegation contained in your letter, the entire output of Newport has not been and will not be diverted to the owners of Wilport. . . . They will constitute stable, long-term customers of Newport, which, because of their financial interest in Newport, will bolster rather than hurt Newport's position if and when a buyer's market may develop in steel. . . .

"Newport has not sold its steel and does not propose to sell its steel on the grey market for the reason that such action is, in the opinion of the management, contrary to the public interest and

⁷⁴ The case had been filed on October 2, 1950. On December 11, 1950, the case of *Pertman v. Newport Steel Corp.* was filed in the United States District Court for the Northern District of Indiana, the state in which the defendant was incorporated.

⁷⁵ Arthur Kramer, Inger Lawrence, Muriel Lawrence, A. Charles Lawrence, Edith Lawrence, and James J. Lawrence, as joint tenants with right of survivorship.

contrary to the long-range financial interests of Newport and its shareholders. . . .

"... We suggest that you investigate these matters further before resorting to the suggested 'legal remedies', which we believe are unwarranted, unnecessary and not in the best interests of Newport or of its stockholders including your clients.'⁷⁵

On March 26, 1951, these shareholders filed an action in the United States District Court for the District of Connecticut, against—in addition to Newport Steel Corporation, C. Russell Feldmann and Charlotte E. Feldmann, who had been named as defendants in the action instituted in the name of Jane Perlman—Joseph V. McKee, Jr., Carolyn Otto, Phyllis M. McKee, and Barbara Jane Feldmann.⁷⁷

On May 28, 1951, an order was entered consolidating the two actions. Perlman's action had already been consolidated, on February 5, 1951, with an action filed in the name of Emily Reumert on January 18, 1951, against the same parties being sued in the name of Jane Perlman.⁷⁸ On September 13, 1951, Harry Mernoff, whose suit had been dismissed by the United States District Court for the District of Connecticut in an order dated July 13, 1951,⁷⁹ was permitted to intervene as a party plaintiff.⁸⁰ The

⁷⁶ Plaintiffs' Brief, *supra* note 10, at 237a–40a (Exhibit 2 Annexed to Answer of Defendant, Newport Steel Corporation, to Supplemental Consolidated Complaint).

⁷⁷ A suit by these plaintiffs was also filed in the United States District Court for the Southern District of New York on November 8, 1950.

⁷⁸ An action filed by Reumert in the United States District Court for the Southern District of New York on December 28, 1950, was stayed by consent of the parties.

See generally Finding of Fact 131, *Perlman v. Feldmann*, 129 F. Supp. 162, 182 (D.Conn. 1952):

131. Demand by plaintiffs upon the stockholders of Newport to bring this suit would have been futile because:

(a) Under the laws of Indiana, Burns' Annotated Indiana Stats. 1948, § 25-208, the directors and not the stockholders manage the affairs of Newport, including the bringing of action for it. The stockholders as a body cannot by resolution manage Newport or compel its management to bring suit.

"(b) Compliance by Newport's management with a stockholders' resolution to bring this action would have left the conduct of the action in hostile hands and it could not have been properly prosecuted.

(c) Efforts to secure action by Newport's stockholders would require a proxy fight with Newport's management. The management controls approximately 37% of Newport's outstanding stock. The remaining stock of Newport is widely dispersed among several thousand shareholders whose identity changes from day to day. The management is in control of Newport's proxy machinery. An attempt by plaintiffs to displace Newport's management would have been unavailing.

⁷⁹ *See* note 68 and accompanying text *supra*.

⁸⁰ An action brought by him in the New York Supreme Court, New York County, and served upon one of the defendants January 31, 1951, was subsequently dismissed.

general counsel for all plaintiffs in the suit was the New York City law firm of Pomerantz, Levy, Schreiber & Haudek.

The trial concluded on November 30, 1951, and final judgment was entered on December 8, 1952. In his opinion, Judge Hincks defined and analyzed the issues requiring decision as follows:

“It is the plaintiffs’ claim that the sale of stock, with an accompanying transfer of Newport’s corporate offices to Wilport’s nominees, constituted a breach of Feldmann’s fiduciary duties to the corporation which resulted in “profits” to the defendants for which they are accountable to Newport. And to understand what the plaintiffs mean by ‘profits’ in the context of this case one must have in mind that the challenged transaction occurred some time after our national entrance into the Korean enterprise as a result of which there was a ‘short’ or ‘gray’ market in steel. In that situation steel producers were in a position to exact for their product from hungry end-users of steel a price premium over and above prices fixed on the basis of mill costs. There was then no ‘black’ market because at the time sales at a premium were not illegal. There was, however, a ‘gray’ market in which sales were made at premiums. This market, out of patriotic considerations, reputable producers (and so far as the record shows Newport qualified for this classification) declined to enter: without legal compulsion they agreed to forego their advantage and to sell at not above posted prices which tied in with their respective mill costs. The plaintiffs say they have no criticism of Feldmann’s management of Newport for its self-restraint in this respect. But they contend that, since Feldmann’s sale of a control block was to a group of end-users of steel, who were thus enabled to divert Newport’s production to themselves, at a price allegedly in excess of the value of the stock but for the effect of the gray market, this excess of value which was covered into the purchase price received by Feldmann (and his associates) was in effect a gray market premium and constituted a ‘profit’ on a ‘corporate asset’ wrongfully diverted from the corporation into Feldmann’s individual pocket.

“The defendants deny that there has been a breach of any duty owed to Newport. It is their position that the transaction in question was merely a sale of a block of stock with the rights and powers attaching thereto. They assert also that if any of Feldmann’s acts as an officer or director are in issue, these acts were ratified by vote of the shareholders at Newport’s annual meeting on February 19, 1951 and therefore cannot now be made the basis of an action by the corporation.

“On analysis it will be seen that the basic question in the case is one of law. In the state of the steel market as it existed on August 31, 1950, was the admitted power inherent in a control block of corporate stock to control the distribution of Newport’s product and to select those who may become its customers a corporate asset as the plaintiffs contend, or was it something properly pertaining to the ownership of a control block of stock the value of which was necessarily and properly reflected in the value of the stock as the defendants contend? . . .”⁸¹

“Where a stockholder has power through his control of management to control distribution of the corporate product, whether he exercises his power or leaves it in abeyance, or whether he transfers it with his stock to another, the corporate balance sheet is not thereby affected. To view the power in management, or in a stockholder through his control over management, to select the customers of the company as a corporate asset in itself, is to indulge in a confusion of thinking which would introduce unsettling confusion throughout the world of commerce. For the power to select customers if an asset is one having value only because it carries ability to command a premium price for the corporate product—a condition obtaining only in a seller’s market when demand exceeds supply: in a buyers’ market no such condition exists. What chaos would ensue if a corporate balance sheet to have precise definition required adjustment for every shift in the balance between supply and demand—and if, to determine the rights of a corporation vis-à-vis a particular stockholder, it were necessary to determine not only the balance between demand and supply for the corporate product but also whether the particular block of stock involved, considered for its relation to the current distribution of all the stock, carried practical control of the corporation!

“The plaintiffs’ repeatedly expressed assumption that in the situation here the power to control the corporate distribution was a *corporate asset* is scarcely consistent with their prayer that the defendants be required to pay over the consideration therefor not to the corporation for the benefit of all stockholders but instead to stockholders exclusive of Wilport, the largest stockholder of all. Nor is such an assumption supported either by citation of authority or by reason. Even assuming that the price received by Feldmann reflected the value of the power to control distribution of the corporate product, it is fallacious to argue that the sale

⁸¹ Perlman v. Feldmann, 129 F. Supp. 162, 183 (D.Conn. 1952).

cloaked a gray market transaction whereby Feldmann, whose management led Newport to forego premium prices on its product which it might have obtained for the benefit of all stockholders, obtained individually the equivalent of a price premium in capitalized form for the benefit only of the minority stockholders who owned the control block. If members of the Wilport group in gray market transactions had merely bought steel from Newport at a premium they would have remained free from responsibility for producing steel and all the hazards which attend the steel industry. Instead, by a capital investment they made a long-range commitment to the production of steel and accepted the attendant vicissitudes. This feature of the transaction takes it outside the gray market. . . .”⁸²

“From this it follows that the price received is not invalidated as evidence of value merely because it reflects the value of the power to control distribution. And here there is no evidence of circumstances surrounding the sale, such as fraud, duress, mistake, etc., which if present would destroy or impair the probative effect of price received as evidence of value. That being so, the evidence of an actual price, determined by the process of arm’s-length negotiations as to the value of a control block between informed parties—the principal seller having long been the active, responsible, executive of the business and the buyers being a group which had made a painstaking investigation of all phases of the business and had had the benefit of expert advice of its own choosing—is by far the most convincing evidence as to value in the record. Certainly its reliability far exceeds the opinion testimony of any of the experts, or price quotations for small lots. The defendants are thus entitled to a dismissal because a great preponderance of the evidence shows that each received no more than a pro rata share of the fair value of the block sold.

“The simple holding just indicated is decisive of the case, as will be apparent when one examines its impact on every position taken by the plaintiff.”⁸³

Notice of appeal was filed on January 7, 1953. Emily Reumert did not join the appeal from the judgment. In an opinion dated September 24, 1953, Chief Judge Hincks resolved various disputes concerning bills of costs and objections filed by various parties.⁸⁴ On December 11, 1953, after payment of a \$12,500 fee

⁸² *Id.* at 184-85.

⁸³ *Id.* at 185.

⁸⁴ *Perlman v. Feldmann*, 116 F. Supp. 102 (D. Conn. 1953). *See, e.g., id.* at 113-114: The plaintiffs claim that all costs to Newport incurred as incidental to

to plaintiffs' counsel by Wilport,⁸⁵ the United States District Court in Delaware dismissed with prejudice Civil Action No. 1390—*Birnbaum, et al. v. Wilport Company and Newport Steel Corp.*⁸⁶—a stockholders' suit seeking an injunction against the sale of steel to the the Wilport group, a declaration that the new management was improperly in office, an accounting, and damages.⁸⁷

active participation in the defense should be dissolved. Newport is the corporate beneficiary which failed and refused to bring the action in its own name. Since it thus declined to assume the role of a plaintiff the plaintiff brought the action allegedly in its behalf naming Newport as a defendant. Concededly, it was a necessary party. But plaintiffs claim that its position as a defendant was nominal only in that it stood to gain by the litigation without hazard of loss. On that account their contention is that it is not entitled to such costs as were incurred because of its active and voluntary participation in the defense.

This contention is overruled. The bringing of the action required Newport, acting of course through its board of directors, to decide whether actively to participate in the defense or not. This required an honest determination of whether the corporate interest required its participation. It may well have decided that the plaintiffs' claim was unfounded and that no recovery was reasonably to be expected for its benefit. Indeed, its prior failure and refusal to sue imports that such was its judgment. That left for decision the question whether the prosecution of the action, even though it should eventually prove unsuccessful, might be harmful to the corporation, if the prosecution were left to proceed without constant and active representation in behalf of the corporation. That Newport answered this question in the affirmative, is to be inferred from the fact that it did participate.

I do not understand the plaintiffs to dispute that these questions were within the scope of managerial authority vested in a board of directors: the gist of their contention is, rather, that the power was not wisely or honestly exercised. However, the plaintiffs at no time, at trial or before, sought to challenge Newport's right to defend. On the contrary, in their pre-trial discovery proceedings plaintiffs on several occasions took advantage of Newport's presence *as an adversary party*. But this aside, if a challenge to the right were now directly before me for decision, and had been timely presented, I would rule that there is no showing in the record of the case of fraud or other exceptional factors which would justify a court in countermanding the decisions made by the corporate management. *See Fletcher on Corporations*, Vol. 5, Sec. 2104. I note that by Par. 11 of the complaint it was charged that the new board of directors, which made the decision to participate in the defense, caused the "corporation to embark on a policy" which "will deprive it of substantial profits and *customer good will*." I cannot accept plaintiff's contention that this was only an attack on the present directors in their individual capacities. The allegation was one relating to a corporate policy which the directors might think harmful to the corporation if allowed to stand without refutation or explanation. I note also that the plaintiffs' position throughout was such that they sought to disparage the value of the corporate assets. This effort if unopposed might reasonably have been considered harmful to the corporate credit. And, I think it fair to say, in all its pre-trial phases the issues of the case were in such a highly fluid state, notwithstanding my efforts to limit and define them, that the directors might have thought corporate participation in the trial was necessary to resist or explain unforeseen efforts by the plaintiffs to establish facts having an impact harmful to proper corporate interests.

Of course, I cannot know just what motives or what particular considerations led the corporation to make its decision. In this connection it may be

(iv)⁸⁸

The Court of Appeals panel selected to hear *Perlman v. Feldmann*—which was argued on October 5 and 6, 1954—consisted of Learned Hand, Jerome N. Frank, and Chief Judge Charles E. Clark. As was the custom on the Second Circuit,⁸⁹ memorandums were prepared and circulated after the argument.

In their memorandums dated October 12,⁹⁰ 13,⁹¹ and 15,⁹² 1954, all three judges voted to reverse the District Court's decision on the basis that Feldmann had transferred a corporate asset to Wilport by means of transfer of the stock. Under date of December 27, 1954, a letter was sent to counsel in the case informing them that Judge Hand "had determined that he should hold himself disqualified"—Judge Hand's son-in-law was a member of a law firm serving as attorneys for defendants—and requesting their consent to his replacement on the panel by Judge

worth noting that by the suit no recovery was sought of the directors who made the decision. In view of my own considered decision on the merits I cannot criticize the Board for its conclusion that the action would not result in a recovery for the corporate benefit. And on the whole, even if timely challenge had been made to the corporate right to participate, I could not properly have denied that right. For, even if the need for corporate participation does not affirmatively appear, nothing has been shown which would warrant me in substituting my judgment for that of the Board as to the existence of that need.

If, as I thus hold, Newport had a right to participate, it must follow that on entry of a decree for the defendants, Newport is entitled to taxable costs incurred incidental to the exercise of that right.

⁸⁵ See Reply Brief for Plaintiffs-Appellants at 11, *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955).

⁸⁶ (Civ. Action No. 1390 (D. Del. 1953).

⁸⁷ See Defendants' Brief, *supra* note 2, at 38.

⁸⁸ Much of the Second Circuit material in this section is based on the Charles E. Clark papers for access to which I wish to thank the Library of the Yale Law School.

⁸⁹ M. SCHICK, *LEARNED HAND'S COURT* 96 (1970):

In the large number of cases not disposed of summarily, the judges of the Second Circuit follow a practice "hallowed by tradition" and "believed to be unique" among American appellate courts. The judges do not confer until about a week or so (usually the Wednesday or Thursday) after argument. In the interim, each judge working independently prepares a memorandum—actually a tentative opinion—on every case not yet decided, in which he gives his views and vote. It is understood that what is said in a memorandum does not preclude changes of mind later [footnotes omitted].

⁹⁰ Learned Hand memorandum at 2, 3:

The question does, however, remain whether the plaintiffs have shown that Feldmann took to himself some benefits that might have come to Newport. In several earlier instances Newport had availed itself of the "Feldmann Plan," by which Newport borrowed from its customers without paying any interest upon the loan. That was really one form of "gray marketing" and was "unethical" (horrid illiterate word) so far as any breaking of the published prices was "unethical." Newport had in fact found it profitable to give a commitment in the very recent past; and it was a fair inference that it could have exacted a similar profit on this occasion, and would have done so, since no scruples would have intervened.

Thomas W. Swan (retired).⁹³ Consent from all counsel having been received by the end of the month, the Clerk was directed on December 31, 1954, to transmit the appendices and briefs to Judge Swan, and the latter, in a memorandum dated January 4, 1955, adumbrated the dissent he was later to publish. Finally, both the Frank⁹⁴ and Hand⁹⁵ memorandums suggested barring Wilport Stock (at the time held by Merritt-Chapman & Scott)⁹⁶ from sharing in the recovery, a holding contained in the opinion Clark wrote for the panel.

The opinion of the United States Court of Appeals for the Second Circuit was dated January 26, 1955. On February 9, 1955, Newport Steel Corporation filed a Petition for Rehearing raising the following issue:

Hincks, J., seemed to question whether, since the transaction was "unethical," the court would hold its nose and compel Feldmann to disgorge. I suppose he was thinking of the bill for an accounting by one highwayman against another that Popham, J., entertained; but on this occasion it was the other shareholders that Feldmann deprived of a benefit, and they were not personally implicated. Besides, the fault, if it was one, was not of a kind that stank so much in the nose of the court that the fiduciary could keep his swag.

Besides, we don't have to rely upon the benefit in cash that Newport might have exacted in consideration of giving Wilport an indefinite call on its product. That was a right of some value anyway: *i.e.*, the assurance of an option, a call, without any engagement by Wilport to take any part, if the steel market should become a buyer's market. Surely it would have been unlawful for Newport to give such a call without consideration. Yet by the sale of his shares, Feldmann did commit Newport to just that; for as the controlling shareholder Wilport obtained power to take as much steel as it needed, when it needed it, and not to take anything if the demand should slacken.

⁹¹ Jerome N. Frank memorandum at 1:

Judge Hincks held that the "power" to control the "distribution" of the company's product—which power was acquired by Wilport (buyer of Feldmann's shares)—did not constitute "an asset of the corporation" (*i.e.*, Newport). For that reason, Hincks said he was not finding what part of the \$20 a share was paid for the acquisition of that power.

But I think this power was a corporate asset. I think the evidence sufficiently shows that, in the period of steel shortage, this power could have yielded financial gain to the corporation. (It might not have been obtained by the company directly in cash, but indirectly through a "Feldmann Plan" or otherwise).

With that fact sufficiently established, Feldmann had the burden of showing what part of the price (if any) represented Feldmann's sale of that power, since, by his conduct, he made the proof difficult. *Package Closure Corp. v. Sealright Co.*, 141 F. (2d) 972, 979 (C.A.2); *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 265-266; *Story Parchment Co. v. Paterson Co.*, 282 U.S. 555, 565-566.

If Feldmann did gain through the sale of that power, he is in no position to argue that it would have been unethical for the company to sell it for gain.

Feldmann is a shrewd businessman, as the record shows. It is therefore unbelievable that he was not aware that the shares' buyers intended to use that power for their selfish benefit without paying the company therefor. If he did receive some cash for the sale of the power, he must have been aware of that fact, *i.e.*, that he was deriving some gain from the sale of a corporate asset.

It is the contention of the petitioner that the court erred in ordering the aforesaid profits to be paid directly to stockholders and a rehearing on this sole issue is requested.⁹⁷

After citing and quoting from a number of decisions from various jurisdictions, the petition concluded its argument in the following terms:

This learned Court has cited the cases of *Seagrave Corp. v. Mount*, 212 F.2d 389 (6th Cir. 1954) and *Southern Pacific Co. v. Bogert*, 250 U.S. 483 (1918) as the basis for its awarding damages in a stockholders' derivative suit proportionally to the stockholders of the corporation. Petitioner desires to call to the attention of the court that the *Southern Pacific* case was not a stockholders' derivative action. Mr. Justice Brandeis who delivered the opinion of the Court stated at page 487 as follows:

In considering the many objections urged against the decree, it is important to bear constantly in mind the exact nature of the equity invoked by the bill and recognized by the lower

⁹² Charles E. Clark memorandum at 1, 2:

Feldmann's liability turns on whether the sale of his stock is viewed as merely a personal transaction or as including an asset of the corporation, for which Feldmann had to account to it. Judge Hincks held that the power to derive economic benefits from a favorable market by advantageous choice of customers was not a corporate asset because it was not reflected on the business sheets of the corporation. This seems an unduly restrictive meaning of corporate property in the light of *Young v. Higbee Co.*, 324 U.S. 204, in which an appeal from confirmation of a reorganization plan was considered an asset for which fiduciaries had to account. And Judge Hincks elsewhere relied on a broader concept of corporate property when he assessed defendant's stock on the basis of prospective corporate earnings, a standard more intimately related to the market than to balance sheet calculations. Perhaps it is a bit wooden or overreification to call all this a bit of "corporate property" I incline to plaintiffs' expression—as semantically neater (sic)—of corporate fiduciary power in trust.

⁹³ Thomas W. Swan retired on July 1, 1953.

⁹⁴ Jerome N. Frank memorandum at 2:

The decree could be that he account to the corporation. But I think there is justification for a decree that he pay directly to the holders of the stock not sold to Wilport their proportionate share (about 70%) of the amount of his improper gain.

⁹⁵ Learned Hand memorandum at 4:

[T]he value of [Finding 120] for Feldmann's purpose disappears because of the last sentence: 'What value the block would have had, if shorn of the appurtenant power to control distribution of the corporate product, the evidence does not show.' That is exactly the issue that Feldmann had to prove, and in so far as he fails he must repay to the corporation the price he got, though Wilport cannot keep its share of that recovery.

⁹⁶ See part A (iv) *supra*.

⁹⁷ Petition for Rehearing at 2, *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955). Cf. note 83 *supra*.

courts. The minority stockholders do not complain of a wrong done the corporation or of any wrong done by it to them. They complain of the wrong done them directly by the Southern Pacific, and by it alone. . . .

The *Seagrave* case concerned itself only with the enjoining of certain defendants from consummating a certain purchase of stock. This case involved no monetary award whatsoever.

This Court in its opinion on page 436 thereof states that "Defendants cannot well object to this form of recovery. . . ." Petitioner, Newport Steel Corporation, however, a defendant in the action, very definitely objects to being deprived of the recovery of damages sustained by it. Petitioner believes that the effect of the Court's decision is the declaration of a dividend without regard to the financial condition of the corporation, the rights of creditors or its tax situation. In so doing, the Court is usurping the functions of management contrary to its own established law and practice. This Court has recognized that recovery in stockholders' derivative actions belongs to the corporation. See *Green v. Victor Talking Mach. Co.*, 28 F.2d 378 (2nd Cir. 1928).⁹⁸

In a memorandum dated February 15, 1955, Judge Clark noted about the petition that:

This seems to me a properly shrewd move, which I commend on that level; since the lush situation is now deteriorating judicialwise, Newport wants to get back for its crowd of insiders the money paid Feldmann to get its preferred position. But the reasons we gave against this before still stand. Newport's argument seems confined to the semantic level: "since this is a stockholder's derivative suit, ergo." Omit the premise as we should, since it was the other stockholders who were primarily injured, and there is nothing left. Practically our result is the only one which has meaning in any attempt to hold these trade buccaneers to a modicum of morality.⁹⁹

Since Judge Swan, in a memorandum dated February 10, 1955, had already noted that "As I disagreed with the opinion on this point (last paragraph of my dissent) I naturally think the petition should be granted. But if my brothers deny it I shall make no squawk but prefer not to sign the order,"¹⁰⁰ and since Judge

⁹⁸ Petition for Rehearing at 8. *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955).

⁹⁹ Charles E. Clark memorandum at 1.

¹⁰⁰ Thomas W. Swan memorandum at 1.

Frank noted that “I agree with Charlie’s memo of Feb. 15, 1955”,¹⁰¹ a Per Curiam order, signed only by Judges Clark and Frank, denying the petition for rehearing, was filed on February 28, 1955.

On April 22, 1955, a petition was filed in the Supreme Court of the United States, seeking certiorari on the basis that:

Shares of stock are a common article of trade and sales of control blocks of outstanding shares in both small and large companies are an every day occurrence, and every day shares are sold in the open market at prices far above or far below book value.

The decision of the Court of Appeals is a drastic departure from the existing law regarding stock ownership, and is contrary to every other court decision on this important question. This novel decision is of all-pervading importance as it affects the rights of every stockholder of every corporation, whether large or small.

Although theoretically the decision below can be said to represent only the view of the Second Circuit, it will be read by lawyers and businessmen throughout the country as an expression of general law. This is particularly true because the decision below purports to apply what it regards as the universal requirements of equity and cites as its authorities cases in this Court and the courts of states other than Indiana.

If the decision of the Court of Appeals is permitted to stand, it will not only create a federal rule at variance with the corporate laws of the several states but it will invite endless stockholders’ litigation because of the impossible burden of proof which is imposed upon the sellers. No one selling a control block of shares could ever know to whom he may sell or at what price, because he cannot know what value a court will subsequently find after the shares are hypothetically shorn of one or another attribute of control necessarily transferred with the voting rights inherent in the shares.¹⁰²

The Brief in Opposition to a Writ of Certiorari, filed on May 23, 1955, by the firms of Pomerantz Levy & Haudek, as General

¹⁰¹ Jerome N. Frank memorandum at 1 (February 21, 1955).

¹⁰² Petitioners’ Brief for Certiorari at 27-28, *Feldmann v. Perlman*, 349 U.S. 952 (1955).

Counsel for Respondents, and Proskauer Rose Goetz & Mendelsohn, as Appellate Counsel for Respondents,¹⁰³ concluded its arguments by pointing out that:

The decision below was interlocutory. Certiorari "is and generally should be issued only after a final decree"; *Panama R. Co. v. Napier Shipping Co.*, 166 U.S. 280, 284 (1897). Review of interlocutory decisions is allowed only where "necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause"; *American Construction Co. v. Jacksonville T. & K. W. R. Co.*, 148 U.S. 372, 384. No such extraordinary circumstances have been shown. On the contrary, if petitioners, as they now contend, can demonstrate upon the accounting that the price they received was no more than the fair value of their stock, there will be no liability and the legal issues will be academic. The application for certiorari is therefore premature.

Nor does the case involve any of the broad questions which petitioners would seek to present to this Court. The decision below rests, not on the sweeping generalities which petitioners would impute to the Court of Appeals, but on the application of familiar principles of fiduciary law to the particular facts of this case.¹⁰⁴

A Reply Brief having been filed by Petitioners on May 31, 1955, certiorari was denied on June 6, 1955,¹⁰⁵ and the case therefore remanded to the United States District Court for the District of Connecticut. District Judge Robert P. Anderson,¹⁰⁶ in an opinion dated July 18, 1957, defined the task he had just completed in the following terms:

The problem has been to find the fair market value of the Newport Steel Corporation as a going concern, *i.e.* its enterprise value, on August 31, 1950. For the purpose of evaluating the control block shorn of the power to control the

¹⁰³ On Briefs filed in the United States Court of Appeals for the Second Circuit, Pomerantz Levy & Haudak are listed as General Counsel for all Plaintiffs and Attorneys for Plaintiff-Appellant. Jane Perlman, Proskauer Rose Goetz & Mendelsohn are listed as Appellate Counsel for all Appellants and Attorneys for Plaintiffs-Appellants. Arthur Kramer, Inger Lawrence, Muriel Lawrence, A. Charles Lawrence, Edith Lawrence, James J. Lawrence, and Isaac Wagner; and Nemerov & Shapiro and William Rosenfeld as Attorneys for Plaintiff-Intervenor-Appellant, Harry Mernoff, Perlman v. Feldmann, 129 F. Supp. 162, 163 (D. Conn., 1952) lists attorneys for plaintiffs as follows:

Pomerantz, Levy, Schreiber & Haudak, New York City, Saltman Weiss & Connors, Bridgeport, Conn., Sidney L. Garvin, Abraham S. Ullman, New Haven, Conn., Proskauer Rose Goetz & Mendelsohn, New York City, Marsh Day & Calhoun, Bridgeport, Conn., Nemerov & Shapiro, William Rosenfeld, New York City.

¹⁰⁴ Brief for Respondents at 28, Feldmann v. Perlman, 349 U.S. 952 (1955).

¹⁰⁵ Feldmann v. Perlman, 349 U.S. 952 (1955).

corporation's output of steel, the court has accepted the mathematical sequel of dividing the enterprise value of the corporation by the number of shares outstanding and multiplying the result by the number of shares in the block. What special value there may have been to an investor in being able to manage the corporation without controlling or having any particular interest in using the product or channeling its distribution to end users in which he was interested, is implicit in the factors going to determine enterprise value. In this case it is found that the difference between the value of the block thus arrived at, and the amount paid the individual defendants by the Wilport Company constituted a bonus or premium paid the individual defendants by the Wilport Company to control the corporation's output of steel.

The conclusion as to enterprise value of the Newport Steel Corporation on August 31, 1950, was arrived at by the experts for the plaintiffs and the experts for the defendants by somewhat different means. Each tended to emphasize factors which were helpful to the side for which he was testifying. The plaintiffs' expert gave great weight to records of earnings for several years prior to August 31, 1950 and little weight to changes in means and equipment for production and sales in the few months preceding August, 1950, the changes in demand for products and the reasonably foreseeable consequences of these changes in the period following August 31, 1950. The defendants' expert, on the other hand, relied heavily on a projection into the future of the higher earnings achieved in the recent past plus increased or normalized earnings by the new steel facilities, insufficiently tempered by the negative consideration of increased taxes.

The court has been greatly assisted by observing the tools used by the experts and their procedures in using them; but it has adopted the final conclusion of neither.¹⁰⁷

He concluded that:

After considering all of the evidence relative to the various divisions of the Newport Steel Corporation the court has adopted what it has conceived to be the methods best adapted to disclose the fair market value of each of the divisions as part of the going concern. The total of the values of each of these divisions has been found to be \$15,825,777.53, which is the enterprise value of Newport Steel Corporation. Each

¹⁰⁶ Judge Carroll C. Hincks was appointed to the United States Court of Appeals for the Second Circuit on December 7, 1953.

¹⁰⁷ *Perlman v. Feldmann*, 154 F. Supp. 436, 447-48 (D. Conn. 1957).

share therefore had a fair market value on August 31, 1950, of \$14.67 and the premium or bonus per share was \$5.33.¹⁰⁸

In an opinion dated March 5, 1958, Judge Anderson found "that a reasonable and proper allowance, under the circumstances of this case, for attorneys' fees for the attorneys appearing for the plaintiffs and those whom they represent is \$450,000. There is also allowed, in addition, the reasonable expenses incurred by counsel in the total sum of \$38,329.73"¹⁰⁹

Of these amounts, Pomerantz, Levy & Haudek and Associates received \$274,000 in fees and \$30,714.61 in expenses; Proskauer, Rose, Goetz & Mendelsohn and Associates received \$173,000 in fees and \$6,829.12 in expenses; Sidney L. Garwin and Associates received \$1,800 in fees and \$486.00 in expenses; and Nemerov & Shapiro and Associates received \$1,200 in fees and \$300.00 in expenses.¹¹⁰

Judge Anderson further held that "[a]fter payment of the above listed fees and expenses, the remainder of the amount recovered by the plaintiffs in the settlement of the case (\$1,150,000) will be divided among and distributed to the plaintiffs and those whom they represent in proportion to the shares held by each, whether such shares are represented by certificates of stock or non-negotiable receipts of Newcorp, Inc. The words 'those whom they represent' are construed to mean and are found to be the holders of shares (exclusive of the Wilport shares)¹¹¹ of Newcorp, Inc., either in certificates of stock or non-negotiable receipts, as listed on the books of the Company as of the close of business on September 30, 1957."¹¹²

(v)

In an article entitled "Abe Pomerantz Is Watching You," *Fortune* magazine delineated a jurisprudential basis for proceed-

¹⁰⁸ *Id.* at 451.

¹⁰⁹ Perlman v. Feldmann, 160 F. Supp. 310 (D. Conn. 1958).

¹¹⁰ *Id.* at 311. Compare note 103 *supra*, with note 113 and accompanying text *infra*.

¹¹¹ See note 96 and accompanying text *supra*. Cf. a story entitled "Wolfson, Gerbert Retrial Ends in Deadlocked Jury" in the Wall Street Journal of May 9, 1972, at 2, col. 3:

A mistrial was declared when a federal jury failed after three days to agree on a verdict on charges of perjury and securities law violations against Florida financiers Louis Wolfson and Elkin B. Gerbert. . . .

The charges against Mr. Wolfson, of Miami Beach, and Mr. Gerbert, of Jacksonville, involved a connection with Merritt-Chapman & Scott Corp., of which Mr. Wolfson was board chairman. Merritt-Chapman, a construction company that became a conglomerate, went into liquidation last year.

¹¹² Perlman v. Feldmann, 160 F. Supp. 310, 311 (D. Conn. 1958).

ings such as those to a history of which part B of this article has been devoted:

In the first twenty or thirty years of this century, most stockholder suits were instigated by lawyers whose principal aim was to be bought off, and actions of this kind became known as strike suits. . . .

No one would guess from the style in which Pomerantz lives and works that in an average year he makes well over \$350,000, a figure that only ten or twelve other lawyers in the U.S. can match. . . .

Pomerantz' dislike for conspicuous consumption is no doubt associated with the fact that for more than forty years he has been a socialist. . . .

In Pomerantz' lifetime, the social status of the stockholder lawyer has improved. Even many corporation lawyers now believe that some of the full-disclosure provisions of the post-1929 securities laws can be more efficiently policed by lawyers like Pomerantz than by the government. . . .

As a device for keeping corporate officers honest, however, the stockholder suit has a serious flaw. In a 1964 opinion Judge Henry J. Friendly of the U.S. Court of Appeals pointed out, "The plaintiff stockholders or, more realistically, their attorneys have every incentive to accept a settlement that runs into high six figures or more, regardless of how strong the claims for much larger amounts may be. . . . A juicy bird in the hand is worth more than the vision of a much larger one in the bush." . . .

This puts a heavy burden on the conscience of the plaintiff's lawyer. Pomerantz points out, "There's no flesh-and-blood client you have to look in the eye while you're explaining why you want to settle for a tenth of what you are suing for. In a suit where you're representing 40,000 stockholders, there's always the temptation to tell yourself, 'Well, I'm getting them something; why knock myself out?' In the end it's a matter of plain conscience." Pomerantz finds this depressing, since he believes that conscience is a weak reed to lean on in business affairs. "My professional experience has taught me that fiduciary duty usually succumbs to that old devil self-interest or acquisitiveness."¹¹³

C. The Precedent

(i)

As a lawyer who practiced corporate law in the middle 1960's,

¹¹³ Klaw, *Abe Pomerantz Is Watching You*, 77 FORTUNE 144, 146, 161 (Feb., 1968).

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I can testify that at least some of the corporate bar viewed *Perlman v. Feldmann* as “a drastic departure from the existing law regarding stock ownership . . . [creating] a federal rule at variance with the corporate laws of the several states.”¹¹⁴ The scholarly work that stated the feared change most precisely was an article entitled “The Stockholder’s Right to Equal Opportunity in the Sale of Shares” by William D. Andrews,¹¹⁵ which proposed the rule that “. . . whenever 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.”¹¹⁶

That rule has not become the law in the years since *Perlman v. Feldmann*. One explanation for this state of affairs is that “It should . . . be apparent that there is no logical relation between the rule of equal opportunity and the problems of looting and corporate squeezes with which it seems mainly designed to deal, [which] problems . . . do not require any transfer of control.”¹¹⁷ An academic analysis is phrased in economic terms:

In effect then, the rule of equal treatment would impose higher capital requirements on beneficial purchasers in a substantial number of transactions. Professor Andrews inappropriately assumes, however, that the purchasers should be willing to meet these higher costs because the investment value of the additional shares is the same. He errs in that his reasoning is incomplete. It is true that the investment value is the same. But even if the capital market did function perfectly and the purchaser could arrange the financing, a rational businessman might not want to buy all the shares at a premium price justified by the investment potential. It might be sensible to decline to buy more than the bare amount necessary for control on the principles of diversification of risk and of opportunity. This might render the equal treatment rule ineffectual as a means of automatically distinguishing “good” and “bad” purchasers. I would think that the number of prospective beneficial purchasers prevented because of a desire to diversify will be much larger than those simply unable to raise the capital. Until empirical evidence is adduced to the contrary, I am predisposed to consider this cost of restraining

¹¹⁴ See note 102 and accompanying text *supra*.

¹¹⁵ Andrews, *The Stockholder’s Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965).

¹¹⁶ *Id.* at 515.

¹¹⁷ Letts, *Sales of Control Stock and the Rights of Minority Shareholders*, 26 BUS. LAW. 631, 646 (1971).

beneficial transactions substantial when compared with the cases of detriment with which the present law is incompetent to deal. . . .

Aside from the elegance of the ideal, which I leave to commentators on reapportionment, it seems that “equality” can only be justified if it somehow improves the functioning of the securities market. Admittedly it might restrain detrimental transactions, but at great cost. It might on the other hand be contended that equality would so improve the psychology and faith of investors, as the securities acts are alleged to do, that all present shareholders would be benefited by the influx of new shareholders. But it is proper to note in closing that in corporation law it is the maximization of profits that is the overriding principle, and unlike the political arena, equality is not justified for its own sake.¹¹⁸

It was precisely the political theme of “equality,” however—the extent to which the mechanisms of the voting franchise granted to the corporate shareholder are subject to the ideological pressures of democracy in United States society—that produced a recent decision—*Medical Comm. for Human Rights v. SEC*¹¹⁹—demonstrating, when its rationale is appraised in conjunction with that of *Perlman v. Feldmann*, many of the ways in which legal control of the corporation in American society is different today from what it was ten or twenty years ago.

(ii)

Since the purpose of this Section is to assess the precedential significance of *Perlman v. Feldmann*—the meaning of that decision today—it seems appropriate, before exploring the broader question of the changes in the meaning of corporate law produced by the passage of time, to question whether the type of attack made on the transaction with which we are concerned in the case of *Birnbaum v. Newport Steel Corp.* continues to be subject to “the inadequacies of state court jurisdiction”; whether, in other words, “the broadly remedial purpose of Congress to grant protection to the public and investors against all types of fraud [in §10(b) and Rule X-10B-5] is limited in accordance with [that] decision.”¹²⁰

¹¹⁸ Javares, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 32 U. CHI. L. REV. 420, 426, 428 (1965).

¹¹⁹ 432 F. 2d 659 (D.C. Cir. 1970), *dismissed as moot*, 404 U.S. 403 (1972).

¹²⁰ See note 72 and accompanying text *supra*.

The present status of the *Birnbaum* decision was perhaps most succinctly put by a District Judge in the very Circuit in which it was rendered, who recently held that "although some courts have held that a private party not a purchaser or seller, seeking *injunctive* relief, may have standing to assert a §10(b) violation . . . and another has suggested the elimination of the purchaser-seller requirement . . . it is still the rule in this Circuit that the requirement be satisfied in a suit for damages."¹²¹

Another procedural ruling related to *Perlman v. Feldmann* which may well not be the law today is the opinion by Hon. C. C. Hincks in *Mernoff v. Ballantyne*.¹²² In an opinion dated January 13, 1972, the United States District Court for the Eastern District of Pennsylvania held as follows:

The Securities Exchange Act of 1934 is designed to put an end to interstate frauds in the sale and trading of securities. It would be difficult, if not impossible, to accomplish this purpose if, when a complex scheme is alleged involving defendants from many states, venue for a particular district would have to be established as to each alleged participant in the illegal plan by proving that his illegal acts in furtherance of the fraud were committed in that district. An unnecessary multiplicity of suits and fragmenting of the issues involved would be the result of such a venue requirement. I follow the lead of many other courts in reading 15 U.S.C § 78aa as providing that venue is proper as to all defendants in any district where it is alleged that any one defendant has committed acts that are violative of the act and in furtherance of the alleged illegal scheme [citations omitted].¹²³

Both *Mernoff* and *Birnbaum* were, however, the law when *Perlman v. Feldmann* was decided;¹²⁴ the question, moreover, is what *Perlman v. Feldmann*, not *Birnbaum*, means today.

¹²¹ *Ingenito v. Bermec Corporation*, 376 F. Supp. 1154, 1185 (S.D.N.Y., 1974) (citations omitted).

¹²² See note 68 and accompanying text *supra*.

¹²³ In *Re Penn Central Securities Litigation*, 338 F. Supp. 438, 440 (E.D. Pa. 1972).

¹²⁴ Cf. *Jannes v. Microwave Communications, Inc.*, 461 F.2d 525, 528-30 (7th Cir. 1972) (footnotes omitted):

The district court had dismissed the *Bankers Life* case primarily upon the authority of the *Birnbaum* case. . . . In other words, *Birnbaum*, in interpreting the words "in connection," required a fairly direct nexus between the alleged fraud and the purchase or sale of a security.

The district court in *Bankers Life* held that the superintendent of insurance as liquidator of Manhattan had standing to maintain an action regarding the sale of Manhattan's portfolio of United States bonds. But the fraud, although "a complicated scheme of common law fraud" and "a scheme to loot a corporation of its assets," was not a "federal fraud" because of its lack of effect on the public interest in maintaining free and open securities markets.

(iii)

The erosion of the *Birnbaum* rationale represents, it should be noted, not simply a replacement of state by federal law in terms of the source to which a court looks for the standards to be applied to the transaction before it, but also an attempt to provide for the regulation of transactions which had formerly escaped regulation because of "the inadequacies of state court jurisdiction."¹²⁵ Since the standard to be applied is Rule X-10B-5 and the agency ultimately charged with its application is a federal district court, the demise of *Birnbaum* represents a determination to permit shareholders, utilizing standards promulgated by a federal administrative agency, to resort to federal courts for protection against certain types of transactions.

Ten or twenty years ago, however, attempts to regulate corporate transactions and to protect corporate shareholders were focused on pursuit of that general goal called "shareholder democracy." The champions of these campaigns were such as Wilma Soss and John J. and Lewis Gilbert; the arenas in which they were waged were shareholders' meetings rather than federal courts; and the federal statutory provision most often at issue was § 14(a)¹²⁶

In affirming, the court of appeals held that the fraud alleged "in no way affected either the securities market or the investing public. No stockholders were defrauded, no investor injured. The purity of the security transaction and the purity of the trading process were unsullied." 430 F.2d at 361. The court also quoted *Birnbaum* in stating, "Rule 10b-5 was not intended to provide a remedy for schemes amounting to no more than 'fraudulent mismanagement of corporate affairs.'" 430 F.2d at 360.

In reversing the lower courts, Mr. Justice Douglas, speaking for the unanimous Supreme Court, held that a cause of action respecting the sale by Manhattan of its Treasury bonds had been charged under section 10(b). . . .

In the present case the complaint alleged that MCI suffered an injury as a result of deceptive practices touching its purchase of securities when it received only 25 percent of the Mi-Com stock for its valuable assets. There is also the claim that MCI issued its own shares to controlling shareholders for less than adequate consideration *Ruckel v. Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964); *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert denied*, *Manley v. Schoenbaum*, 395 U.S. 906, 89 S. Ct. 1747, 23 L. Ed. 2d 219 (1969).

Neither counsel for the plaintiffs in struggling to state a federal claim nor the district court in failing to find a federal claim could anticipate that the Supreme Court would effect a change in the *Birnbaum* principles.

But that decision compels us to reverse the district court judgment for the reason that under *Bankers Life* the second amended complaint stated a federal claim.

¹²⁵ See note 120 and accompanying text *supra*.

¹²⁶ Sec. 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n, provides for the regulation of proxies and the information contained therein. Rule 14(a)-8(S), 17 C.F.R. § 240.14a-8(c) (1970), specifically relates to "Proposals of Security Holders," and contains the following relevant provisions:

rather than § 10(b). The extent to which this goal of “shareholder democracy” has served as the justification for regulation of the activities of corporate management by federal courts and by the Securities and Exchange Commission is illustrated by the proceedings in *SEC v. Transamerica Corp.*¹²⁷

In a letter dated January 2, 1946, John J. Gilbert, holder of seventeen shares of Transamerica Corporation, informed management of four proposals which he wished presented for action at the annual stockholders’ meeting to be held April 25, 1946, one of which involved the repeal of By-Law 47 and its replacement by one not containing the requirement that notice of any proposed alteration or amendment of the By-Laws be contained in the notice of meeting. By-Law 8 required management to call a special meeting upon receiving a request in writing from holders of a majority of the stock in the corporation, and amendment of a By-Law could be the purpose for which stockholders requested such a meeting; By-Law 47—in the absence of such a request—was interpreted by management as conferring upon it discretion to omit notice of a By-Law amendment desired by a stockholder from the notice of the annual meeting. Notice of the meeting, proxy statements, and proxies for the annual meeting scheduled for April 25, 1946, were mailed to stockholders beginning March 18, 1946. The proxy material contained a statement that a stockholder had indicated his intention to present certain proposals for action at the meeting, but that such proposals would be ruled out of order if presented because they were not mentioned in the notice of the meeting.

In the District Court, the Securities and Exchange Commission (which had notified management on March 29, 1946, that its failure to comply with Gilbert’s requests was a violation of proxy rules) argued that John J. Gilbert’s attempts to bring proposals to the attention of the shareholders at the annual meeting “cannot be circumscribed by arbitrary procedural obstacles created by management, for the requirement that a notice of a proposed amend-

[M]anagement may omit a proposal . . . from its proxy statement and form of proxy under any of the following circumstances:

(2) If the proposal:

(i)
 (ii) Consists of a recommendation, request, or mandate that action be taken with respect to any matter, including a general economic, political, racial, religious, social, or similar cause, that is not significantly related to the business of the issuer or is not within the control of the issuer . . .

¹²⁷ The material in the following paragraph is based on *SEC v. Transamerica Corp.*, 67 F. Supp. 326, 327-328, 332 (D. Del. 1946).

ment should be contained in the notice of the annual meeting—as a condition precedent for its consideration at the meeting—was intended to protect stockholders and not to give management a device which they can arbitrarily utilize to prevent consideration or vote on a stockholder's proposal, simply because management does not choose to mention such proposals in the notice of meeting."¹²⁸

The District Court rejected this argument on the basis that "[t]here is nothing in the General Corporation Law of Delaware or in the charter or by-laws of Transamerica Corporation which requires it to give stockholders notice of any by-law amendment which a shareholder desires to submit at an annual meeting. If the Board of Directors refuses to notice an amendment which a shareholder deems desirable, he must seek his remedy in other channels."¹²⁹

The United States Court of Appeals for the Third Circuit reversed this holding by the District Court: "If this minor provision may be employed as Transamerica seeks to employ it, it will serve to circumvent the intent of Congress in enacting the Securities Exchange Act of 1934. It was the intent of Congress to require fair opportunity for the operation of corporate suffrage. The control of great corporations by a very few persons was the abuse at which Congress struck in enacting Section 14(a). We entertain no doubt that Proxy Rule X-14A-7 represents a proper exercise of the authority conferred by Congress on the Commission under Section 14(a). This seems to us to end the matter. The power conferred upon the Commission by Congress cannot be frustrated by a corporate by-law."¹³⁰

The proposals Gilbert was attempting to bring to the attention of the shareholders were a change in the place at which the annual meeting was held from Wilmington, Delaware, to San Francisco, California; the election of independent public auditors by the shareholders; and a requirement that a report of the annual meeting proceedings be sent to all shareholders. The extent to which perceptions of needed corporate reforms had undergone a drastic transformation in the years after the *Transamerica* decision was demonstrated on March 11, 1968.

On that date Dr. Quentin D. Young of the Medical Committee

¹²⁸ *Id.* at 331.

¹²⁹ *Id.* (footnote omitted).

¹³⁰ *SEC v. Transamerica Corp.*, 163 F.2d 511, 518 (3d Cir. 1947), *cert denied*, 332 U.S. 847 (1948) (footnote omitted).

for Human Rights wrote to the Secretary of the Dow Chemical Company, stating that the Medical Committee had obtained by gift several shares of Dow stock and proposing the following wording to be sent to stockholders:

RESOLVED, that the shareholders of the Dow Chemical Company request the Board of Directors, in accordance with the laws of the State of Delaware, and the Composite Certificate of Incorporation of the Dow Chemical Company, to adopt a resolution setting forth an amendment to the Composite Certificate of Incorporation of the Dow Chemical Company that napalm shall not be sold to any buyer unless that buyer gives reasonable assurance that the substance will not be used on or against human beings.

In a letter dated March 21, 1968, the General Counsel of Dow Chemical informed the Medical Committee that the proposal had arrived too late for inclusion in the 1968 proxy statement.¹³¹

When the Committee renewed its request the following year, having modified the last section of its proposal to provide that "the company shall not make napalm," Dow Chemical responded that it intended to omit the proposal from the 1969 statement under the authority of subsections of SEC Rule 14a-8. "The Committee requested that Dow's decision be reviewed by the staff of the SEC. On February 18, 1969, the Chief Counsel for the Division of Corporation Finance wrote both Dow and the Committee to inform them that 'this Division will not recommend any action to the Commission if this proposal is omitted from the management's proxy material.' . . . The SEC Commissioners granted a request by the Committee that they review the Division's decision and affirmed it. . . . The Committee then sought and obtained review of the Commission's decision in the United States Court of Appeals for the District of Columbia Circuit, [which] on July 8, 1970 . . . held . . . that the validity of the Commission's determination was extremely dubious . . . and that the case should be remanded to the Commission for reconsideration."¹³²

That the Court of Appeals justified its action on an ideological basis closely akin to that which underlay the *Transamerica* decision is clear from the concluding passages of its opinion:

¹³¹ The material in this paragraph is based on Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 661-62 (D.C. Cir. 1970).

¹³² SEC v. Medical Committee for Human Rights, 404 U.S. 403, 404-05 (1972).

No reason has been advanced in the present proceedings which leads to the conclusion that management may properly place obstacles in the path of shareholders who wish to present to their co-owners, in accord with applicable state law, the question of whether they wish to have their assets used in a manner which they believe to be more socially responsible but possibly less profitable than that which is dictated by present company policy. . . .

. . . The management of Dow Chemical Company is repeatedly quoted in sources which include the company's own publications as proclaiming that the decision to continue manufacturing and marketing napalm was made not *because* of business considerations, but *in spite of* them; that management in essence decided to pursue a course of activity which generated little profit for the shareholders and actively impaired the company's public relations and the recruitment activities because management considered this action morally and politically desirable. . . . The proper political and social role of modern corporations is, of course, a matter of philosophical argument extending far beyond the scope of our present concern; the substantive wisdom or propriety of particular corporate political decisions is also completely irrelevant to the resolution of the present controversy. What *is* of immediate concern, however, is the question of whether the corporate proxy rules can be employed as a shield to isolate such managerial decisions from shareholder control. After all, it must be remembered that "[t]he control of great corporations by a very few persons was the abuse at which Congress struck in enacting Section 14(a)." *SEC v. Transamerica Corp.*, *supra*, 163 F.2d at 518. We think that there is a clear and compelling distinction between management's legitimate need for freedom to apply its expertise in matters of day-to-day business judgment, and management's patently illegitimate claim of power to treat modern corporations with their vast resources as personal satrapies implementing personal political or moral predilections. It could scarcely be argued that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation; and it seems equally implausible that an application of the proxy rules which permitted such a result could be harmonized with the philosophy of corporate democracy which Congress embodied in section 14(a) of the Securities Exchange Act of 1934.¹³³

¹³³ *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 681 (D.C. Cir. 1970), *dismissed as moot*, 404 U.S. 403 (1972) (footnote omitted).

The difference between this case and *Transamerica*, however, is that in this instance federal judicial power was utilized to overturn rather than support the action of the federal administrative agency.

(iv)

Before exploring the question of the relevance of the *Medical Committee* decision to the precedential significance of *Perlman v. Feldmann*, it remains to identify the holding in that case: to attempt to define in reasonably precise terms the factors that justified the action taken by the Second Circuit Court of Appeals in connection with the payments received by Feldmann for stock that constituted a controlling interest in Newport Steel Corporation.

The *New York Times* story quoted in part A (i), *supra*, described the case in the following terms;

Mr. Feldmann sold a controlling block of stock in the company for \$8,000,000 during the Korean War steel shortage. The stockholders asserted that a portion of his profits belonged to the corporation and should have been shared by them.¹³⁴

Furthermore, in the judicial opinion which led to that story, Judge Anderson pointed out that:

The circumstances leading up to the [Korean War], and the impact of the war itself created rising prices and a heightened demand for steel and other goods. The plaintiffs object to any emphasis at all on these changed economic conditions, but the resulting boom and the gray market conditions, pointing up the demand for steel, should not be considered as a factor showing that the defendant received a premium for their block of stock and at the same time be denied or disregarded in considering enterprise value as of August 31, 1950.¹³⁵

Indeed, the Third Defense in the Answer of Defendant Newport Steel Corporation to the Consolidated Amended Complaint in *Perlman v. Feldmann* was that:

¹³⁴ See note 1 and accompanying text *supra*.

¹³⁵ *Perlman v. Feldmann*, 154 F. Supp. 436, 448 (D. Conn. 1957). See also Connolly, *Perlman v. Feldmann and the Sale of Control—A Brief Reconsideration*, 26 BUS. LAW. 1259, 1262 (1971):

Perlman v. Feldmann did not penalize the sale of control *per se*. Sale of control to the *Wilport* syndicate during the Korean war was held unlawful.

[T]his defendant says that if there is a prevailing scarcity of steel products with an attendant potential for the advantageous disposition by this defendant of its plant, equipment or output on a gray or black market, such is not a corporate asset, as neither this defendant nor any other reputable producer or handler of steel should be or is doing anything to capitalize on, condone or cooperate in such business practices. Any suggestion that this defendant should sell its products surreptitiously for amounts in excess of its established mill prices, or upon conditions or requirements that seek to capitalize on and exploit the current national emergency, is unpatriotic and in direct contravention of the letter and spirit of the public policy, declarations and regulations of the Federal Government, and would involve illegal price discrimination. Any such practice would be flagrantly inconsistent with the best long-range interests of this defendant and basically unwise, since it would justifiably undermine its good will, would augment and contribute to the graveness of the current national economic emergency, and would be detrimental to this defendant, to the steel industry generally, and to the economy of the country.¹³⁶

Viewing *Perlman v. Feldmann* from an economic as well as ethical¹³⁷ perspective, Professor Andrews noted that:

The premium Feldmann received for his stock was clearly, in the peculiar circumstances of the case, a form of payment of a higher price for steel. The court accepted, *arguendo*, Feldmann's argument that Newport could not ethically realize on the market situation through higher prices. But it does not follow that Feldmann, a fiduciary for the corporation by all views, is then free to appropriate for himself the whole value of the premium a purchaser is willing to pay; "it ill becomes the defendants to disparage as unethical the market advantages from which they themselves reaped rich benefits." All this suggests that the decision in *Feldmann* rests on the peculiarities of a market situation in which users were unable effectively to reflect their demand by bidding up the price of steel itself, but were able to reflect the same pressures in a bid for stock of a steel company.¹³⁸

¹³⁶ Plaintiffs' Brief, *supra* note 10, at 220-21a.

¹³⁷ *Cf.* note 90 *supra*.

¹³⁸ Andrews, *supra* note 115 at 514 (footnotes omitted). *Cf.* Finding of Fact 49, *Perlman v. Feldmann*, 154 F. Supp. 436, 442 (D. Conn. 1957):

The dominant motive of this purchasing group in seeking to purchase Feldmann's controlling stock interest in Newport was to obtain a continuing source of steel supply. Feldmann knew during the negotiations that such was their motive.

Insofar as *Perlman v. Feldmann* represents, therefore, an attempt by the Court of Appeals to re-allocate the premium created by the market pressures which Andrews described, the fact that the Court could not justify its holding by reference to Congressional legislation raises the possibility that *Perlman v. Feldmann* conflicts with *Youngstown Sheet and Tube v. Sawyer*,¹³⁹ decided by the Supreme Court of the United States in 1952, insofar as the latter case can be read as applying to the judiciary as well as to the executive.

“In an era generally dominated by insecurity, 1952 was a peak of frustration and bitterness on the American scene. The Korean War was entering its third year, 128,000 American casualties had been spent, and the end seemed nowhere in sight. Truce negotiations at Panmunjom were conducted fruitlessly all year, in the midst of ammunition duels and alarming reports of Communist troop build-ups. Riots in the Communist prisoner of war compounds were a constant irritant. As the war continued to unsettle the domestic economy—producing an unpopular draft, uneven wage and price controls, and a mounting inflation—the limited-war effort came under severe attack. Yet extending the war in space or weapons was opposed by our Allies, by most of our military leaders, and by much of the American public as well.

“With our foreign policy tied in this Gordian knot, frustrations poured into the domestic debates, particularly on the issue of loyalty and internal security. Set in the context of Senator Joseph McCarthy’s charges that government, colleges, and the communications media were ‘honeycombed with Communists,’ 1952 saw John Carter Vincent dismissed by the State Department as a loyalty risk, Owen Lattimore indicted for denying to a Senate Subcommittee that he was ‘pro-Communist,’ and Julius and Ethel Rosenberg’s conviction (for passing atomic secrets to the Russians) upheld on appeal. From hundreds of Republican orators came the charge that Democrats could not be trusted to safeguard the nation from Communist agents, a challenge which added biters to the already tart cup of political discourse.

“On the larger political front, 1952 featured a running battle between the Fair Deal Democratic Administration of President Harry Truman and a Congress firmly controlled by a Republican-Southern Democratic coalition. More of Truman’s domestic legislative proposals were rejected by Congress in 1952 than in any previous year of his tenure, with Congressional disaffection

¹³⁹ 343 U.S. 579 (1952).

ranging from Tidelands oil and immigration issues to wages and price policies and re-organization of executive agencies. Throughout the legislative session, the Truman Administration was the subject of steaming investigations into tax frauds, influence peddling and 'softness toward Communism,' while Republican presidential hopefuls ripped open each Truman proposal to see whether a campaign issue might be hidden inside. Even Truman's announcement in March that he would not be a candidate for re-election failed to sweeten executive-legislative relations. Mr. Truman left no doubt that he considered "his record" to be the issue at the coming presidential contest, thus providing a characterization that Republican Congressmen rushed to second, and Southern Democrats saw as a continued threat to their position within the party. Economic-group lines duplicated this division. Big Labor was happily committed to the party of the "Little Warrior" of 1948, while Big Business was determined to leave no check unsigned in the effort to place a Republican on Pennsylvania Avenue.

"One product of these varied tensions was widespread labor unrest. More strikes took place in 1952 than in any year since 1946. Three and one half million workers left their jobs in industries such as coal, construction, petroleum, telegraph, and maritime, with cries from each side that the other would have to bear the stain of Korean casualties on its palms. The most serious labor dispute of 1952 took place in the nation's most important and strategic industry — steel."¹⁴⁰

"At 10:30 P.M. on April 8, 1952, former President Truman went to the American people with a message which touched off the legal battle of the century. 'Tonight', he said, 'our country faces a grave danger. We are faced by the possibility that at midnight tonight our steel industry will be shut down. This must not happen'. Therefore, he said, 'I am directing the Secretary of Commerce to take possession of the steel mills, and to keep them operating'."¹⁴¹

"In *Youngstown Sheet and Tube v. Sawyer* the Supreme Court invalidated, as inconsistent with the Taft-Hartley Act, [the] war-time presidential 'seizure' of strike-threatened steel mills, although Congress did not disapprove the seizure after the President promptly requested congressional review and agreed to abide

¹⁴⁰ A. WESTIN, *THE ANATOMY OF A CONSTITUTIONAL LAW CASE: YOUNGSTOWN SHEET AND TUBE CO. V. SAWYER: THE STEEL SEIZURE DECISION* 1, 2 (1958).

¹⁴¹ Banks, *Steel, Sawyer, and the Executive Power*, 14 U. PITT. L. REV. 467 (1953) (footnotes omitted).

by congressional policy. Presidential authority to authorize hostilities was not in issue, and the court did not doubt its capacity to appraise the constitutional basis for the nonmilitary presidential order, interpret the relevant statutes, and administer a return to private control."¹⁴²

"Common sense requires that any discussion of executive power should be anchored to the Separation of Powers Doctrine. Why do we have, as far as is practical, immutable walls between the three departments of the Government? The answer lies in experience. For experience has taught us that a concentration of executive, judicial, and legislative power in the same hands can only mean the suppression of liberty and the oppression of tyranny. The experience of the English people with their kings who sought or exercised unbridled prerogatives, was available to the framers of the Constitution when they met at Philadelphia. And they sold the Constitution to the American people on the ground that that instrument was not calculated to thrust us upon the sword of despotism. 'Were the federal Constitution, therefore, really chargeable with the accumulation of power, or with a mixture of powers, having a dangerous tendency to such an accumulation, no further arguments', said Madison, 'would be necessary to inspire a universal reprobation of the system. I persuade myself, however, that it will be apparent to every one, that the change cannot be supported. . . .'"¹⁴³

¹⁴² Ratner, *The Coordinated War-making Power—Legislative, Executive, and Judicial Roles*, 44 S. CAL. L. REV. 461, 487 (1971) (footnotes omitted).

¹⁴³ Banks, *supra* note 141, at 497 (footnote omitted). Cf. D. ACHESON, *PRESENT AT THE CREATION: MY YEARS IN THE STATE DEPARTMENT 414-415* (1969) (footnote omitted):

My recommendation was that the President make a full report on the Korean situation to a joint session of Congress. This would, of course, be largely formal but would bring the whole story together in one official narrative and meet the objection of some members that information had come to them only through the leaders and the press. I also recommended that the President should not ask for a resolution of approval, but rest on his constitutional authority as Commander in Chief of the armed forces. However, we had drafted a resolution commending the action taken by the United States that would be acceptable if proposed by members of Congress. . . .

There has never, I believe, been any serious doubt—in the sense of nonpolitically inspired doubt—of the President's constitutional authority to do what he did. The basis for this conclusion in legal theory and historical precedent was fully set out in the State Department's memorandum of July 3, 1950, extensively published. But the wisdom of the decision not to ask for congressional approval has been doubted. To have obtained congressional approval, it has been argued, would have obviated later criticism of "Truman's war." In my opinion, it would have changed pejorative phrases, but little else. Congressional approval did not soften or divert the antiwar critics of Presidents Lincoln, Wilson, and Roosevelt. What inspired the later criticism of the Korean war was the long, hard struggle, casualties, cost, frustra-

As in *Medical Committee*,¹⁴⁴ in other words, the Court could be said, in *Perlman v. Feldmann*, to be exercising governmental powers normally wielded by legislators and/or administrative agencies. An argument could be made, of course, that the seizure of “profits”¹⁴⁵—of a “premium”—is sufficiently different from the seizure of steel mills—of real property—to obviate any possibility of conflict between the *Perlman* and *Youngstown* cases; the holding of *Perlman v. Feldmann*, then, would be simply that it violates the law for a corporate fiduciary to profit from economic pressures resulting from the type of national war-time emergency presented by Korea.

The difficulty with this holding, however, is that it seems so squarely in conflict with *Medical Committee*, where “. . . management in essence decided to pursue a course of activity which generated little profit for the shareholders and actively impaired the company’s public relations and recruitment activities because management considered this action morally and politically desirable.”¹⁴⁶ Thus, even if both *Perlman v. Feldmann* and *Medical Committee* can be justified as examples of the general rule that national war-time emergencies constitute special circumstances

tion of a limited and apparently inconclusive war, and—most of all—the determination of the opposition to end seemingly interminable Democratic rule.

Nevertheless, it is said, congressional approval would have done no harm. True, approval would have done none, but the process of gaining it might well have done a great deal. July—and especially the first part of it—was a time of anguishing anxiety. As American troops were committed to battle, they and their Korean allies under brutal punishment staggered back down the peninsula until they maintained only a precarious hold on the coastal perimeter around Pusan. An incredulous country and world held its breath and read the mounting casualties suffered by these gallant troops, most of them without combat experience. In the confusion of the retreat even their divisional commander, Major General William F. Dean, was captured. Congressional hearings on a resolution of approval at such a time, opening the possibility of endless criticism, would hardly be calculated to support the shaken morale of troops or the unity that, for the moment, prevailed at home. The harm it could do seemed to me far to outweigh the little good that might ultimately accrue.

The President agreed, moved also, I think, by another passionately held conviction. His great office was to him a sacred and temporary trust, which he was determined to pass unimpaired by the slightest loss of power or prestige. This attitude would incline him strongly against any attempt to divert criticism from himself by action that might establish a precedent in derogation of presidential power to send our forces into battle. The memorandum that we prepared listed eighty-seven instances in the past century in which his predecessors had done this. And thus yet another decision was made.

¹⁴⁴ See note 133 and accompanying text *supra*.

¹⁴⁵ Cf. note 82 *supra*.

¹⁴⁶ SEC v. Medical Comm. for Human Rights, 439 F.2d at 681.

shifting the balances usually maintained between judicial and legislative or administrative power, the fact remains that one Court of Appeals held against Feldmann on the grounds that he had profited from the Korean national wartime emergency while another Court of Appeals held against "[t]he management of Dow Chemical Company" for "proclaiming that the decision to continue manufacturing and marketing napalm was made not *because* of business considerations, but *in spite* of them."¹⁴⁷

Only if the Korean and Vietnam conflicts are sufficiently different to justify such seemingly contradictory results does it appear justifiable to accept as valid today the *Perlman v. Feldman* holding delineated above.¹⁴⁸ The last two sections of this part C will attempt to adumbrate precisely such a distinction.

(v)

"Unlike the European colonies liberated from Japan in South-

¹⁴⁷ *Id.*

¹⁴⁸ Cf. Junger, *Down Memory Lane: The Case of the Pentagon Papers*, 23 CASE W. RES. L. REV. 3, 19, 31 (1971):

Despite the fact that the *per curiam* opinion in *New York Times* in no way refers to *Youngstown* or the doctrine of separation of powers, I do not see how the case can be understood without reference to these matters. Although perhaps only Mr. Justice Marshall actually accepted Professor Bickel's argument (and only Mr. Justice Harlan used a similar argument in dissent), it appears to me that the only principle accepted by a majority of the Court was that the Executive lacked the inherent power to impose, without legislative authority, prior restraints upon the press so as to prevent the publication of news which allegedly would have adverse effects upon our war in Southeast Asia. And this principle seems to follow *a fortiori* from the holding of *Youngstown* that the executive branch lacked the inherent power to seize the nation's steel mills in order to prevent a strike which allegedly would have adverse effects upon the conduct of our war in Korea. *A fortiori*, because in *Youngstown* it seems clear that Congress could have sanctioned the seizure, whereas in *New York Times* there is the "heavy presumption" against constitutional validity or even a congressionally authorized prior restraint on expression. A brief review of the opinions in *New York Times* will, I believe, establish that only the *Youngstown* rationale secured the adherence of a majority of the Court. . . .

Youngstown arose during the Korea "war"; *New York Times* during the Vietnam "war." Neither of these wars was declared by Congress and in both cases the Executive argued that the war made its actions necessary. In *Youngstown* the steel plants were seized to prevent a strike that supposedly would have had catastrophic effects on the war effort; in *New York Times* the executive branch justified the censorship upon the ground that publication of the paper would have adverse effects on the conduct of the war, as well as on our relations with other countries.

There is, however, one major procedural distinction between *Youngstown* and *New York Times*. In *Youngstown* the Executive acted on its own initiative in seizing the steel mills and it was the steel companies who sought an injunction against the Executive's action. In *New York Times* it was the Executive who sought an injunction against the papers' action. So, despite all the parallels that I have noted, the cases are not on all fours. *New York Times* is *Youngstown* turned upside down. . . .

east Asia, Korea suffered no reoccupation by former rulers. Instead, she was taken over and bisected by two victorious powers, one of which (the U.S.S.R.) had prepared for this, the other of which (the U.S.A.) had not. . . .

“In the north the Russian aim, to create a Communist satellite state, was comparatively definite and was achieved in successive stages. As the Soviet forces came in, the Japanese generally fled to the south, and Communist-trained Koreans were guided in building up a Soviet-type state north of the closed border on the 38th parallel. First, Communist elements got control of the ‘people’s committees’ that were being organized at each level of government—county, municipal, and provincial—while opponents were got rid of in one way or another (something like a million North Koreans migrated to the South). Secondly, a number of manipulated ‘democratic’ parties were set up to mobilize workers, farmers, youth, women (now ‘emancipated’), adherents of the Ch’ongdogyo sect, and others in a national front. Finally, Soviet intransigence having doomed any reunification, elections were held in November 1946, with almost everyone voting, followed by a Convention of People’s Committee at the capital, P’yongyang, in February 1947, which in turn set up a People’s Assembly. This Assembly at once elected a People’s Committee to run a provisional Korean government. At its head was the original Soviet nominee, Kim Il-sung, a young man now bearing the name of a former guerilla leader. The whole process of political indoctrination and mobilization was managed by the dominant Labor (i.e., Communist) Party, supported by Korean ‘people’s militia’ numbering 150,000 or more and guided by Soviet advisers in the background. Along with this political structure went vigorous programs for rural reorganization in the guise of land reform, beginning with confiscation and redistribution of landlords’ estates, together with nationalization of industry and a planned economy in general.

“Organized forcibly from the top down, the North Korean Communist dictatorship, though little studied, seems to have displayed most of the strong and weak points typical of such regimes. Being Korean in form, though actually under Soviet control, it was less offensive than Japanese rule; and its reforms had their attractions for various groups, particularly in the early stages

of the totalitarian metamorphosis. In any case, Russian domination left no alternative."¹⁴⁹

(vi)

"The 'Mandate of Heaven' is the right to rule which is conferred upon a man, a group of men, or a party, by heaven. It has been the source of political legitimacy claimed by all Chinese and Vietnamese emperors. According to the Vietnamese Communists, the 'Mandate of Heaven' was passed on to them by Bao Dai, the last emperor of Vietnam, in 1945 when he willingly gave his ceremonial seal and sword to the representatives of Ho Chi Minh. From the moment of this transfer, the struggle waged by the Viet Minh and its successors, the Democratic Republic of Vietnam and the National Liberation Front, was a moral right and a duty, and to challenge it was immoral. Possession of the 'Mandate of Heaven' guarantees eventual victory, just as the communist interpretation of history guarantees the inevitable victory of communist ideology. Since the Vietnamese Communists believe they have the 'Mandate of Heaven', they must believe they will win. To accept defeat would be to accept that the 'Mandate of Heaven' does not work; it would compromise the philosophy upon which Hanoi's leaders have based their entire lives."¹⁵⁰

"The moment Japan surrendered, [Ho Chi Minh] ordered his fighters into Hanoi. Like de Gaulle himself in liberated Paris, Ho received the acclaim due a wartime hero. Some Americans were with him; among them, General Gallagher and Major Patti of the OSS, who were so moved by the spirit of the occasion that they raised the Stars and Stripes near the Communists' revolutionary banner. Like Sun Yatsen years before, Ho had looked to the United States for help. On September 2, anticipating allied support, ignorant of the Potsdam decision and encouraged by the OSS, Ho issued his own Declaration of Independence. It read in part: 'All men are created equal. They are endowed by their

¹⁴⁹ J. FAIRBANK, E. REISCHAUER & A. CRAIG, *EAST ASIA: THE MODERN TRANSFORMATION* 844-45 (1965).

¹⁵⁰ B. JENKINS, *WHY THE NORTH VIETNAMESE KEEP FIGHTING* 2 (1970) (footnote omitted).

creator with certain inalienable rights, among these are Life, Liberty and the pursuit of Happiness.’¹⁵¹

“Neither in their propaganda nor in the UN did Ho get much Soviet help. Moscow expected that the French Communist Party would establish itself in a French government, and the French Communist Party line was that Vietnam should achieve its independence within the framework of the French Union. One Viet Minh leader told Harold Isaacs that he expected no help from the Soviet Union. ‘The Russians are nationalists for Russia first and above all. They would be interested in us only if we served some purpose of theirs. Right now, unfortunately, we do not seem to serve any such purpose.’¹⁵²

¹⁵¹ M. KALB & E. ABEL, *ROOTS OF INVOLVEMENT: THE U.S. IN ASIA 1784-1971*, 52-53 (1971).

¹⁵² C. COOPER, *THE LOST CRUSADE: AMERICA IN VIETNAM* 51 (1970) (footnote omitted).