**CORPORATIONS**—DERIVATIVE ACTION ON BEHALF OF POLICYHOLDERS FOR THE SALE OF CONTROL OF A CORPORATION HELD NO CONTRACT WILL STAND, NOR BENEFIT ACCRUE TO CORPORATE FIDUCIARIES WHO ACTIVELY CONSPIRE TO PROFIT BY BREACHING THEIR DUTIES OF LOYALTY AND DUE CARE TO THE DETRIMENT OF THE CORPORATION AND ITS POLICYHOLDERS. *Rowen v. LeMars Mutual Insurance Co.*, (Iowa 1979).

John H. Alesch, co-owner of the Alesch, Inc. Insurance Agency,[1] entered into an agreement with the Iowa Mutual Insurance Company for the purchase of all of the outstanding shares of Alesch, Inc. stock at a premium.[2] Prior to the contract's consummation,[3] John Alesch held out control of a third insurance company, LeMars Mutual, as "bait."[4] His ability to deliver such control was a condition of the sale primarily because John Alesch was the single most influential person in the management of LeMars Mutual's affairs.[5] Completion of the transaction, including payment to Alesch, Inc. stockholders, merely awaited the resignation of the LeMars Mutual directors and the election of new ones designated by Iowa Mutual.[6] Subsequently, the LeMars Mutual policyholders filed a derivative class action petition in equity against John Alesch, Alesch, Inc., Iowa Mutual, and those serving in fiduciary capacities as directors, officers and legal counsel to the respective corporations for the illegal sale of control of LeMars Mutual to Iowa Mutual.[7]

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1. John Alesch and his wife each owned one-fourth of the outstanding stock and their three daughters each owned one-sixth. However, John Alesch alone managed Alesch, Inc.'s affairs and dictated its policies. Rowen v. LeMars Mut. Ins. Co., 282 N.W.2d 639, 648 (Iowa 1979). The subject of this case note is the second interlocutary appeal by the LeMars Mutual Insurance Company policyholders. *See* Rowen v. LeMars Mut. Ins. Co., 230 N. W.2d 905 (Iowa 1975).

2. The *Rowen* court recognized that the liability of some of the defendants depended upon whether there was a premium paid for control of LeMars Mutual. Because the purchase price substantially exceeded the value of the stock and because the amount paid by Iowa Mutual was grossly in excess of the value fixed by the trial court, the supreme court determined that Iowa Mutual had paid a premium for Alesch, Inc. *Id.* at 659.

3. *Id.* at 649. The contract was completed on April 21, 1970. Prior thereto, a contract was approved by the LeMars Mutual policyholders in which Alesch, Inc. agreed to provide management services for LeMars Mutual. A new board of directors was elected for Alesch, Inc. and new directors were appointed or elected to the LeMars Mutual board. Rowen v. LeMars Mut. Ins. Co., 230 N.W.2d 905, 908 (Iowa 1979).

4. 282 N.W.2d at 649.

5. *Id.*

6. *Id.*

7. *Id.* at 647-48. Exclusive of LeMars Mutual, there were twenty-five defendants. The principal defendants were Iowa Mutual Insurance Company and its directors, who served as officers, comprised the executive committee, and fixed the policy of the corporation. The LeMars board of directors consisted of nine members. John H. Alesch and Joe Alesch were

Seeking to set aside the sale agreement, the plaintiffs alleged that the premium paid to John Alesch for the Alesch, Inc. stock was used to buy the LeMars Mutual directors' resignation and deliver control to Iowa Mutual.[8] In response, the defendants, together with LeMars Mutual, who was a nominal defendant,[9] filed various procedural motions[10] challenging the trial court's power to rule on the merits. The lower court sustained the motions to dismiss and the motions for summary judgment. The Iowa Supreme Court reversed and remanded the case to trial, finding that the rule requiring exhaustion of administrative remedies was inapplicable and did not require the plaintiffs to first present their claims to the Insurance Commissioner.[11]

On remand, the district court entered its findings of fact and conclusions of law in favor of LeMars Mutual, awarding damages[12] and equitable relief.[13] The Iowa Supreme Court *held,* affirmed in part, reversed in part, and remanded on principal appeal. No contract will stand, nor benefit accrue to corporate fiduciaries who actively conspire to profit by breaching their duties of loyalty and due care to the detriment of the corporation and its policyholders. *Rowen v. LeMars Mutual Insurance Co.,* 282 N.W.2d 639 (Iowa 1979).

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dead at the time of trial. The action was dismissed as to Joe Alesch, and Alice Alesch was made a defendant as the executor of John Alesch's estate. Alesch, Inc. was one of the defendants and the court's reference to the agency includes the directors and stockholders: John Alesch, his wife, and their three daughters. Burton Dull, counsel for LeMars Mutual, was also a defendant. *Id.*

8. 230 N.W.2d at 908.

9. In a derivative action, LeMars Mutual should have taken no active part in the controversy, merely awaiting the outcome and reaping the fruits of any judgment for the plaintiffs; but here the company asserted various cross-claims against the other defendants and took active—even aggressive—part in the trial over the strenuous objections of the other defendants.

282 N.W.2d at 645.

The trial court warned that the ruling regarding LeMars Mutual's status as a defendant was subject to reconsideration and, in fact, was later reversed. The Iowa Supreme Court, however, affirmed the trial court's dismissal of the cross-claims, holding LeMars Mutual had a duty to remain neutral in the struggle between policyholders and corporate personnel. *Id.*

10. The defendants filed a motion for a special appearance, a motion to dismiss and a motion for summary judgment. 230 N.W.2d at 908.

11. 230 N.W.2d at 911-12. Policyholders were not required to first present their derivative and class claims before the Insurance Commissioner where the issues in the case were not technical insurance regulatory matters, but depended on application of common-law corporate tort concepts. *Id.* at 912-13. *See generally* IOWA CODE ch. 521A (1979).

12. 282 N.W.2d at 662. The damages awarded by the district court included a claim against Iowa Mutual for $2,000,000.00 in punitive damages which was subsequently reversed by the Iowa Supreme Court. *Id.*

13. *Id.* at 662-63. The decree directed Iowa Mutual to transfer all outstanding stock of Alesch, Inc. to LeMars Mutual. It ordered the separation of Iowa Mutual from LeMars Mutual, and provided for the appointment of interim directors and the ultimate election of new directors for both LeMars Mutual and Alesch, Inc. under court supervision. *Id.* at 656.

A fiduciary relationship may exist whenever special confidence is reposed by reason of blood, business, friendship or association, or by persons who are in a position to exercise influence over each other.[14] In *Rowen v. LeMars Mutual Insurance Co.*,[15] the Iowa Supreme Court followed the well-recognized principle[16] that corporate officers and directors always and necessarily stand in a fiduciary relation to the corporation, its stockholders and creditors.[17] Because such corporate personnel are said to be fiduciaries and, like trustees, owe a duty of loyalty to the stockholders,[18] transactions with the corporation from which the directors may profit are tainted by a conflict of interest.[19] Nineteenth Century law made all contracts in which the director was interested void at the instance of the corporation or stockholder, regardless of whether it was objectively fair.[20] Today, corporate directors and officers may, upon proper circumstances, transact business with the corporation, but it must be done in strict good faith, with full disclosure of the facts and the consent of all concerned.[21]

Founded upon principles of soundest morality, receiving the clearest recognition by all courts,[22] the Iowa Supreme Court followed the policy of consistently putting fiduciaries beyond the reach of temptation by making it unprofitable for them to yield to it.[23] After distinguishing between the theories of "corporate opportunity" and "sale of control," the *Rowen* court systematically applied a factual analysis of the circumstances surrounding the Alesch, Inc.-Iowa Mutual transaction to John Alesch, the directors of

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14. Dawson v. Nat'l Life Ins. Co., 176 Iowa 362, 376, 157 N.W. 929, 933 (1916).

15. 282 N.W.2d 639.

16. Iowa Southern Utilities Co. v. United States, 348 F.2d 492 (Ct. Cl. 1965); Babineaux v. Judiciary Comm., 341 So. 2d 396 (La. 1976); Alvest Inc. v. Superior Oil Corp., 398 P.2d 213 (Alaska 1965).

17. Gerdes v. Reynolds, 28 N.Y.S.2d 622, 651 (Sup. Ct. 1941).

18. Schildberg Rock Prod. Co. v. Brooks, 258 Iowa 759, 766, 140 N.W.2d 132, 136 (1966).

19. Winter, *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 277 (1977) [hereinafter cited as Winter].

20. *See* Marsh, *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW 35, 36 (1966).

21. Holden v. Constr. Mach. Co., 202 N.W.2d 348, 358 (Iowa 1972).

22. Des Moines Bank & Trust Co. v. Becthel & Co., 243 Iowa 1007, 1081, 51 N.W.2d 174, 216 (1952); *See* Holden v. Constr. Mach. Co., 202 N.W.2d 348 (Iowa 1972); Gord v. Iowana Farms Milk Co., 245 Iowa 1, 16-17, 60 N.W.2d 820, 829 (1953).

23. The *Rowen* court cited Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974) and Holden v. Constr. Mach. Co., 202 N.W.2d 348 (Iowa 1972), wherein the Iowa courts recognized that equity would fashion unusual relief to meet unusual circumstances. 282 N.W.2d at 657. Disallowing the trial court's damage awards against Iowa Mutual and the outside directors of Iowa Mutual, the LeMars board members were each held liable for damages up to $3,000.00. Burton Dull and the Iowa Mutual inside directors were each assessed $25,000.00 in punitive damages. "John H. Alesch (or his estate) [was] not subject to punitive damages because such an award [was] not made against one deceased." *Id.* at 661. It was also futile to assess damages against Alesch, Inc. because it became the property of LeMars Mutual under court decree. 282 N.W.2d at 661.

LeMars Mutual and Iowa Mutual, and LeMars Mutual's attorney, Burton Dull, in order to establish their duties and liabilities. In doing so, the court fashioned a standard that negates any contract where those in a fiduciary capacity actively conspire to profit by breaching their duties.[24]

From the outset it was uncontroverted that LeMars Mutual and Alesch, Inc. enjoyed a unique relationship of independence and prosperity.[25] The Alesch Agency benefited from its in-house location at LeMars Mutual, mirroring the growth of LeMars Mutual and becoming one of the company's most productive sources of business.[26] This working relationship was further complimented by the fact that the chief operating officer and decision-maker, John Alesch,[27] also served as the sole controller of Alesch, Inc., whose fair market value, exclusive of liquid assets, was estimated at $50,000.00.[28] For many years, John Alesch's professional life was devoted to the interests of these corporations.[29] "However, some place along the way he came to view both as vehicles to advance his own interests and lost sight of his separate fiduciary obligations as an officer and director of LeMars."[30] Beginning in November, 1969, the Alesch family entered into a partly writ-

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24. *Id.* at 651. There are two basic types of fiduciary duties a director or officer owes to a corporation: the duty to exercise due care and diligence in the managing of the business and the duty of individual loyalty to the corporation's interests. N. FEUER, PERSONAL LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS 28 (2d ed. rev. ed. J. Johnson 1974) [hereinafter cited as FEUER].

The duty of care standard is expounded under the ABA-ALI MODEL BUS. CORP. ACT § 35 (1976): "A director shall perform his duties as a director . . . in good faith, in a manner he believes to be in the best interests of the corporation, and with such care as an ordinary prudent person in a like position would use under the circumstances."

The director charged with a duty of care must act diligently and exercise an honest and good faith business judgment. Ruder, *The Case Against the Lawyer-Director*, 30 BUS. LAW 51, 55 (1975).

"[T]he concept of loyalty was largely a prohibition against personal gain by the director, either by realizing a business opportunity which comes to his attention through his relationship with the corporation or by participating in a business transaction with his corporation." Hershman, *Liabilities and Responsibilities of Corporate Officers and Directors*, 33 BUS. LAW 263 (1977) [hereinafter cited as Hershman].

25. 282 N.W.2d at 648.

26. *Id.* Alesch, Inc. had an unusual working arrangement with LeMars Mutual. As Lemars Mutual prospered the insurance agency reaped the benefits of location and "easy public identification with a healthy home town insurance company which customers within the local trade wished to patronize." *Id.* at 648-49. Alesch, Inc. was the second biggest producer of business for LeMars Mutual, and the company benefited accordingly. "Both profited by the set-up, which continued at least until the sale of the agency to Iowa Mutual in 1970." *Id.*

27. Rowen v. LeMars Mut. Ins. Co., Equity No. 22, 725, 11 (Plymouth County 1977).

28. The trial court fixed the value at $50,000.00. Additionally, one witness testified that without the control of LeMars Mutual, Alesch, Inc. stock would be worthless. 282 N.W.2d at 659. However, on appeal, the Iowa Supreme Court found that the actual value arrived at by the trial court was low and subsequently set the value at $92,500.00. *Id.*

29. 282 N.W.2d at 649.

30. *Id.*

ten, partly oral agreement with Iowa Mutual for the purchase of the outstanding stock of Alesch, Inc. at a total price of $516,176.16.[31] Thereafter, the Alesch family, the executive committee of Iowa Mutual and LeMars Mutual's attorney, Burton Dull, agreed to conceal, and did conceal, the full agreement[32] from all concerned[33] until the commencement of the litigation.

The court began its analysis by conclusively establishing that John Alesch, the director and the single most influential person in the management of LeMars Mutual, owed LeMars Mutual complete loyalty,[34] honesty and good faith.[35] The court bolstered this assertion with a list of oft-cited cases recognizing a director's fiduciary duties.[36] Because the sales contract for Alesch, Inc. was premised upon John Alesch's promise to deliver, for a premium,[37] the forced resignation of the LeMars Mutual directors and the designation of new ones by Iowa Mutual, the court denied enforcement of the agreement.[38] Although the defendants contended that John Alesch's only intent was to assure continued expert management for LeMars Mutual and Alesch, Inc. after his retirement,[39] the court, relying upon *Rosenfeld v.*

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31. *Id.* at 658. Of the total purchase price "$116,176.16 represented liquid assets consisting of stocks, bonds, cash, and guaranteed accounts. The remaining $400,000.00 was for the outstanding stock of the corporation." *Id.*

32. John Alesch also agreed to seek and obtain the resignation of all the LeMars officers and directors so that designees by Iowa Mutual could be appointed to the LeMars Mutual board. The transaction was contingent upon a pension plan for the retiring LeMars Mutual directors and the purchase of LeMars Mutual of annuity contracts to fund such pensions. Among other enticements, John Alesch and Alice Alesch were also to be employed by LeMars Mutual at $1,000.00 and $500.00 a month respectively.

33. The essential facts of the transaction were concealed from the directors, policyholders, and employees of LeMars Mutual and from the customers of Alesch, Inc. The facts were also concealed from the directors of Iowa Mutual who were not the executive committee members, policyholders of Iowa Mutual, and the Iowa Insurance Commissioner and his employees.

34. 282 N.W.2d at 649. The duty of loyalty is often expressed in terms of the duty to avoid conflicts of interest or self-dealing. FEUER, *supra* note 24, at 28.

35. 282 N.W.2d at 649.

36. *See* Perlman v. Feldman, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517, 525 (Iowa 1974); Holden v. Constr. Mach. Co. 202 N.W.2d 348, 358 (Iowa 1972); Gord v. Iowana Farms Milk Co., 245 Iowa 1, 16-17, 60 N.W.2d 820, 829 (1953); Des Moines Bank & Trust Co. v. Bechtel & Co., 243 Iowa 1007, 1081, 51 N.W.2d 174, 216 (1952).

37. Traditionally, a controlling block of shares of a corporation is usually worth more on the market than a non-controlling block. Thus, the sale of a controlling block of shares at a premium over market value is not necessarily unlawful. However, if the effect of the sale could cause future harm to the corporation with a consequent unusual profit to the selling shareholders, they may be required to account for their gains. *See, e.g.*, Perlman v. Feldman, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. 1941).

The *Rowen* court determined that there was a premium paid for control of LeMars Mutual. 282 N.W.2d at 651. By increasing the value of the stock to $92,500.00, the Iowa Supreme Court reduced the amount of the premium from $400,000.00 to $307,500.00. *Id.* at 659.

38. 282 N.W.2d at 661.

39. *Id.* at 649.

*Black*,[40] found that no matter how high John Alesch's motives were he could not profit from the transaction nor could the court permit the sale of control.[41]

Although the plaintiffs pled and argued their case on the theory of corporate opportunity,[42] the court declined to rely on that doctrine as a separate basis for the result it reached.[43] The *Rowen* opinion cautioned that corporate opportunity was only one phase of a director's undivided loyalty[44] and, instead, vacated the agreement on the basis of the illegal sale of control.[45] Nevertheless, the court added that the studied and deliberate refusal to afford LeMars Mutual an opportunity to acquire Alesch, Inc. was an act of disloyalty and a violation of John Alesch's fiduciary duty.[46] In fact, when John Alesch decided to sell his agency, "a business which for years had been operated almost as part of LeMars [Mutual] . . .," he not only failed to give LeMars Mutual the opportunity to buy it, but sold it to a competitor instead.[47]

The rule of "corporate opportunity" as announced in *Guth v. Loft, Inc.*,[48] precluded a corporate fiduciary from acquiring for himself a business opportunity which in fairness belonged to the corporation, and which fell into the corporation's line of business or was an opportunity in which the corporation had an actual or expectant interest.[49] Whether or not a given opportunity met these requirements was a question of fact to be determined from the surrounding circumstances.[50] While Iowa has recognized the doctrine of corporate opportunity,[51] the Iowa Supreme Court concluded that the factual situation under *Rowen* was unlike other corporate opportunity cases. Invariably, corporate opportunity cases have invoked the wrongful *acquisition* of a business or other property rightfully belonging to the corpora-

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40. 445 F.2d 1337, 1343 (2d Cir. 1971), *cert. denied*, 409 U.S. 802 (1972). J. Friendly held that an investment advisor to a mutual fund, which realized profits in connection with appointment of new advisor upon his recommendation, violated a fiduciary duty. *Id.* at 1343.

41. 282 N.W.2d at 649.

42. *Id.* at 660.

43. *Id.*

44. *Id. See* Raines v. Toney, 228 Ark. 1170, ___, 313 S.W.2d 802, 808-09 (1958); Kerrigan v. Unity Savings Ass'n, 11 Ill. App. 3d 766, 297 N.E.2d 699, 704-05 (1973), *modified*, 58 Ill. 2d 20, 317 N.E.2d 39 (1974); Schildberg Rock Prod. Co. v. Brooks, 258 Iowa 759, 768, 140 N.W.2d 132, 137 (1966); Miller v. Miller, 301 Minn. 207, ___, 222 N.W.2d 71, 78 (1974); Gen. Automotive Mfg. Co. v. Singer, 19 Wis. 2d 528, ___, 120 N.W.2d 659, 663 (1963).

45. 282 N.W.2d at 650.

46. *Id.* at 660.

47. *Id.* at 649. "Actually he offered it to *two* possible competitors. His first proposal to Employers Mutual Casualty Company of Des Moines failed." *Id.*

48. 23 Del. Ch. 255, 5 A.2d 503 (1939).

49. *Id.* at ___, 5 A.2d at 511.

50. *Id.* at ___-___, 5 A.2d at 511-15.

51. *See* Schildberg Rock Prod. Co. v. Brooks, 258 Iowa 759, 140 N.W.2d 132 (1966).

tion.[52] In *Rowen v. LeMars Mutual Insurance Co.*, the circumstances involved the actual *sale* by a director of a business which LeMars Mutual had a right to expect would be offered to it.[53]

In *Rowen* the control illegally sold was clearly that of a separate corporation. In most sale of control cases, the sale involved control of the very corporation whose stock was being sold. There was no plausible theory upon which the defendants could explain how the sale of Alesch, Inc. stock could legally carry with it control of LeMars Mutual.[54] The plan was deliberately designed to allow John Alesch, with the help of the other defendants, to sell Alesch, Inc. for a premium by delivering to the purchaser complete control of LeMars Mutual as part of the consideration. John Alesch failed to offer his agency to LeMars Mutual because he could not realize anything from his control of that company. "In other words, he couldn't sell control of LeMars *to* LeMars."[55] As a result, the transaction was even more suspect and contrary to public policy.[56] The court accordingly held the contract unenforceable upon well-settled Iowa law.[57]

Similar judicial decisions on the sale of control have been characterized as unstable and chaotic[58] and perhaps the *Rowen* decision may be no exception. If any unifying principle runs throughout all of the control premium cases, it is that there is no single satisfactory theory of control.[59] Additionally, considerable scholarly energy has been devoted to the sale of corporate control and the appropriate treatment of the resulting premium,[60] including

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52. 282 N.W.2d at 660.

53. *Id.*

54. *Id.* at 650.

55. *Id.*

56. *Id. See also* Aughey v. Windrem, 137 Iowa 315, 320-31, 114 N.W. 1047, 1048 (1908) (contract influencing a guardian to resign his position is void); Cochran v. Zachery, 137 Iowa 585, 589-91, 115 N.W. 486, 487-88 (1908) (contract inducing one to violate his trust is void); Gleason v. Chicago, M & St. P.R. Co., ___ Iowa ___, 43 N.W. 517, 518-19 (1899) (contract calling on one partner to violate his duty to another is unenforceable).

57. 282 N.W.2d at 650. *See* Tschirgi v. Merchants Nat. Bank, 253 Iowa 682, 689-90, 113 N.W.2d 226, 230 (1962); Jones v. Am. Home Finding Ass'n., 191 Iowa 211, 213, 182 N.W. 191, 192 (1921); Dodson v. McCurnin, 178 Iowa 1211, 1214-15, 160 N.W. 927, 929 (1917). *See also* In re Caplan v. Lionel Corp. 20 A.D.2d 301, 303, 246 N.Y.S.2d 913, 915, *aff'd*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964), holding that the sale of control of a corporation has been declared to be violative of public policy because the "management of a corporation is not the subject of trade and cannot be bought apart from actual stock control."

58. Santoni, *The Developing Duties of Controlling Shareholders and Appropriate Restraints on the Sale of Corporate Control*, 4 J. CORP. L. 285, 288 (1979) [hereinafter cited as Santoni].

59. Hazen, *The Sale of Corporate Control: Towards a Three-Tiered Approach*, 4 J. CORP. L. 263, 282 (1979) [hereinafter cited as Hazen].

60. *See, e.g.*, A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 207-52 (rev. ed. 1968); Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Bayne, *Corporate Control as a Strict Trustee*, 53 GEO. L.J. 543 (1965); Bayne, *The Sale-of-Control Premium: The Definition*, 53 MINN. L. REV. 485

a "strict trust" theory espoused by the commentator-counsel for LeMars Mutual.[61] While control may be an "elusive concept for which a number of definitions have been proposed,"[62] one workable definition is the capacity to choose directors.[63] As a corollary, control carries the capacity to influence the board of directors and possibly to dominate it.[64] Justice Brandeis has even called control "a master instrument of the American economy."[65]

Generally, stockholders may dispose of their controlling stock at any time and at such price as they choose.[66] However, the need for some restraints on transferability has been seen where control follows the sale of the shares.[67] The *Rowen* court cited with approval the principle set out in *Essex Universal Corp. v. Yates*,[68] that those charged with corporate management hold control on behalf of the shareholders and, therefore, may not regard it as their own personal property to dispose of as they wish.[69] Nonetheless, this does not mean that control may not accompany the sale of shares.[70] In *Mat-*

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(1969); Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628 (1965); Brudney, *Fiduciary Ideology in Transactions Affecting Corporate Control*, 65 MICH. L. REV. 259 (1966); Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957); Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 32 U. CHI. L. REV. 430 (1965); Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1 (1956); Leech, *Transactions in Corporate Control*, *104* U. PA. L. REV. 725 (1956); O'Neal, *Sale of a Controlling Corporate Interest: Bases of Possible Seller Liability*, 38 U. PITT. L. REV. 9 (1976).

61. David Cowan Bayne, S.J., was co-counsel for the plaintiffs in the *Rowen* proceedings. Under Bayne's strict-trust theory, the controlling shareholder (the "controleur") is a fiduciary (a "strict trustee"); part of his fiduciary responsibilities is the selection of a successor "controleur"; the premium paid in connection with the sale of his controlling interests is a "premium-bribe" to influence his decision in selecting the successor; and as a trustee he is not entitled to keep the excess. *See* Bayne, *The Sale-of-Control Premium: The Disposition*, 57 CALIF. L. REV. 615 (1969) [hereinafter cited as Bayne].

62. Santoni, *supra* note 58, at 287.

63. *Id.*

64. *See* Berle, *"Control" in Corporate Law*, 58 COLUMBIA L. REV. 1212 (1958) [hereinafter cited as Berle].

65. *Id.*

66. Benson v. Braun, 8 Misc. 2d 67, 69, 155 N.Y.S.2d 622, 625 (Sup. Ct. 1956).

67. Santoni, *supra* note 58, at 288. *But cf.* Berle, *supra* note 64, at 1215. The holder of control is not so much the owner of a proprietary right as the occupier of a power position." *Id.*

68. 305 F.2d 572 (2d Cir. 1962) (cited in 282 N.W.2d at 651).

69. *Id.* at 575. *See also* Perlman v. Feldman, 219 F.2d 173 (2d Cir.), *cert. denied* 349 U.S. 952 (1955); Mitchell v. Dilbeck, 10 Cal. 2d 341, 74 P.2d 233 (1937); Doyle v. Union Ins. Co., 202 Neb. 599, 277 N.W.2d 36 (1979); McClure v. Law, 161 N.Y. 78, 55 N.E. 388 (1889); Cox v. Berry, 19 Utah 2d 352, 431 P.2d 575 (1967).

70. *See, e.g.*, Perlman v. Feldman, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955). While sale of control *per se* will not be penalized, if the effect of the sale will "necessarily" cause future harm to the corporation with a subsequent unusual profit to the selling shareholder, the seller may be required to account for the gains. *Id.* at 178. Mayflower Hotel Stockholders Protective Comm. v. Mayflower Hotel Corp., 193 F.2d 666 (D.C. Cir. 1951) (payment of a premium for a clear majority of the outstanding shares is entirely proper even though there is an additional agreement containing the typical seriatim resignation provisions for seating new directors).

*ter of Caplan v. Lionel Corp.*,[71] the New York Court of Appeals held that corporate management was not a subject of trade that could be bought apart from actual stock control, but a change of directors by resignation and the filling of vacancies could be allowed where there had been a transfer of the majority of stock or even such a percentage of the stock as gave working control.[72]

Despite the failure of the courts to agree upon a general treatment of control premium controversies, the majority have usually approved each problem on a case-by-case basis.[73] While liability *per se* for receipt of a premium in sale of control cases has been universally rejected,[74] a variety of approaches have subsequently emerged, each of which seems justified by the facts of a particular case, but when considered collectively fall short of forming a coherent body of law.[75] The most common theory continues to be that unless special circumstances exist, the majority shareholder owes no fiduciary duty to the other shareholders and may keep the control premium.[76]

With the advent of the *Rowen* decision, the Iowa Supreme Court has provided one more approach to the "analytical morass of hybrid theories that may be utilized to recapture a control premium."[77] Recovery of the premium was ordered by the court on the theory that "control" was accepted as a recognized feature of stock ownership, but was not a normal function of a *mutual* insurance company.[78] Generally, mutuals are organized for the purpose of providing insurance for their policyholders at the lowest reasonable cost and are, therefore, characterized as nonprofit organizations.[79] The mutual company differs from the stock organization in many respects. A mutual's policyholders are members and become owners of the organization

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71. 20 App. Div. 2d 301, 246 N.Y.S.2d 913, *aff'd*, 14 N.Y.2d 679, 249 N.Y.S.2d 877 (1964).

72. *Id.* at 303, 246 N.Y.S.2d at 915.

73. Hazen, *Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—and a Proposal for Reform*, 125 U. PENN. L. REV. 1023, 1041 (1977) [hereinafter cited as Hazen—U. PA. L. REV.].

74. *Id.* at 1061. The rule seems to be that while the sale of control *per se* will not be penalized, if the effect of the sale could cause future harm to the corporation with the seller profiting, the court may demand the shareholder to account for his gains. *See* Perlman v. Feldman, 219 F.2d 173, 178 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955). *But cf.* Honigman v. Green Giant Co., 309 F.2d 667 (8th Cir. 1962), *cert. denied*, 372 U.S. 941 (1963) (rejecting Perlman).

The refusal of the courts to adhere to a *per se* approach can be traced to their continual sensitivity to the arguments that some control premiums represent legitimate economic rewards and not the oppression of minority shareholders. Hazen—U. PA. L. REV., *supra* note 73, at 1061.

75. *Id.* at 1060. *See also* note 60 *supra*.

76. Hazen—U. PA. L. REV., *supra* note 73, at 1040.

77. *Id.* at 1060.

78. *See also* Hayes, *Sale of Control of a Corporation: Who Gets the Premium?* 4 J. CORP. L. 243, (1977) [hereinafter cited as Hayes].

79. J. MAGEE & O. SERBEIN, PROPERTY AND LIABILITY INSURANCE at 693 (4th ed. 1967) [hereinafter cited as MAGEE & SERBEIN].

when they place their business with it.[80] There are no shareholders in a mutual company and the policyholder members name the directors who ultimately designate the executive officers who will run the company.[81] Any excess of funds in a mutual company is returned to the policyholders in the form of "dividends," thus reducing the protection costs.[82] On the other hand, the primary interests of the stock organization is to realize a profit.[83] "The shareholders [who need not be policyholders] who are the owners of the enterprise, elect a board of directors which, in turn, selects the operating management of the company."[84] If any dividends are paid to stock company shareholders it is usually characterized as a return on an equity investment, while a dividend to mutual policyholders is mainly a refund of premiums.[85] Therefore, because the sale of control of LeMars Mutual did not involve the transfer of a property right capable of being transferred as in a stock transaction, the sale of control resulted in more adverse consequences to the policyholders.[86]

The eventual outcome of *Rowen v. LeMars Mutual Insurance Co.*, was consistent with earlier Iowa decisions because it followed the more "orthodox" approach[87] of providing relief without adopting the suggested theories of the commentators. Likewise, the *Rowen* case-by-case analysis conforms to the traditional rule that controlling shareholders may sell their shares of stock for whatever price they can obtain if they have no reason to believe that the purchaser will loot or otherwise harm the corporation, and will, therefore, incur no liability if they procure the resignation of the incumbent directors or officers and replace them with the purchaser's nominees.[88]

At the same time, some writers have suggested that such an "orthodox" restraint plus state and federal securities laws[89] may prove inadequate.[90]

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80. J. Long & D. Gregg, Property and Liability Insurance Handbook at 886 (1965) [hereinafter cited as Long & Gregg].

81. *Id.*

82. *Id.*

83. Magee & Serbin, *supra* note 79, at 697.

84. Long & Gregg, *supra* note 80, at 883-84.

85. *Id.* at 886. *See* Iowa Code § 518 (1979), which indicates the separate and distinct treatment in the law for mutual insurance companies.

86. *See generally* Hayes, *supra* note 78.

87. *See* Hayes, *supra* note 78, at 261. Where the circumstances indicate that the controlling shareholder is receiving some unfair advantage, "there are several 'orthodox' theories under which abuses of position by the controlling shareholder can be corrected; these theories assume that in instances where the advantage is not unfair, it is an appropriate attribute of a property right."

88. O'Neal, *Sale of Controlling Corporate Interest: Bases of Possible Seller Liability*, 38 U. Pitt. L. Rev. 9, 47 (1976).

89. The securities laws may provide substantial relief in instances where there has been an abuse of the control position with the sale of securities. *See* Hazen—U. Pa. L. Rev., *supra* note 73; Leech, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725 (1956); O'Neal, *Sale of a Controlling Corporate Interest: Bases of Possible Seller Liability*, 38 U. Pitt. L. Rev. 9 (1976).

Consequently, to alleviate the inadequacies, the legislatures would have to provide the necessary balance to laws governing control transactions, especially those dealing with the transfer of control of a mutual insurance company.[91] While a lack of predictability of a case-by-case analysis has provided no tidy parameters for control premium cases, courts are more able to achieve an equitable result.[92] Nevertheless, corporate planners must still scrutinize each transaction on its merits with an eye toward giving the majority a fair deal.[93] Thus, all transactions in which control is material should be structured to be fair to all corporate constituents.[94] The difficulty remains in defining what constitutes fairness and to form a consistent pattern of analysis.[95]

After recognizing the high degree of fidelity the catalyst-director, John Alesch, owed,[96] the *Rowen* court also held that all who had actively conspired or cooperated with John Alesch to accomplish the illegal sale of control of LeMars Mutual were equally liable because of their violation of fiduciary duties.[97] Using an equitable approach, the Iowa Supreme Court determined the degree of loyalty and due care a director owed a corporation by distinguishing between the director's "inside" or "outside" roles and the status of the corporation at the time of the questionable transaction. Where the corporation became the "victim"[98] of the illegal transfer of control, every director was put on notice of due care[99] and no distinction was made between their outside or inside roles. On the other hand, where the fiduciary duty in question was owed to the purchaser, the outside directors were distinguished.[100]

In discriminating between the duties of inside and outside directors, the *Rowen* court followed the lead of *Escott v. Bar Chris Construction Corp.*[101]

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90. Hayes, *supra* note 78, at 262.

91. *Id.*

92. Hazen—U. PA. L. REV., *supra* note 73, at 1041.

93. *Id.*

94. Santoni, *supra* note 58, at 309-19.

95. *Id.*

96. The court dubbed John Alesch "the catalyst" which eventually led the parties to court. 282 N.W.2d at 648.

97. *Id.* at 651. *See* Raines v. Toney, 228 Ark. 1170, ___, 313 S.W.2d 802, 810 (1958); Des Moines Bank & Trust Co. v. Bechtel, 243 Iowa 1007, 1082, 51 N.W.2d 174, 217 (1952); Gobel, Inc. v. Skipworth, 232 Iowa 382, 388, 3 N.W.2d 551, 554 (1942).

98. 282 N.W.2d at 653.

99. *Id.* at 654. The court found that the LeMars Mutual directors had a duty to inquire and investigate where the circumstances indicated questionable conduct directly affecting their own corporation.

100. This distinction allowed the director to retain all rights and benefits subject only to the requirement that the minority was protected from the fraudulent acts of the majority. 8 U. BALT. L. REV. 341, 348 (1979).

101. 283 F. Supp. 643 (S.D.N.Y. 1968). "An 'outside director' is usually defined as one who is neither an officer nor an employee of the corporation." 282 N.W.2d at 652, *citing* COHEN & LOEB, DUTIES AND RESPONSIBILITIES OF OUTSIDE DIRECTORS 44 (1978).

In *Escott*, suit was brought by purchasers of fifteen-year debentures for material falsifications and omissions on registration statements. The "inside" directors who had actual knowledge of the registration misstatements were held to a higher degree of due diligence than the lawyer-director who had prepared the statements, but had no actual knowledge of the misstatements.[102] Even less diligence was expected of the "outside" directors who had no actual knowledge of the facts and who played no part in drafting the registration statements.[103]

With few exceptions,[104] outside directors do not have the same duty or responsibility that falls upon those who are in active charge and who dictate day-to-day policy.[105] The duties of outside directors must be determined upon the facts of each case.[106] The key distinguishing factor of the outside director's position is independence.[107] Such independence, however, does not require an outside director to take an adversarial approach toward management, to characteristically dissent from management's proposals, or to assume without proof that management is not dealing in good faith.[108] Management's knowledge and experience in corporate affairs must always be superior to those who play a part-time role as outside directors.[109]

Although no guidelines have been formulated for determining when circumstances are sufficiently suspicious to prompt a duty to investigate on the part of directors,[110] one approach has been to analyze the ease with which the corporation's assests can be looted.[111] The *Rowen* court cited *Insuran-*

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102. 283 F. Supp. at 684-703; FEUR, *supra* note 24, at 139-40.

103. *Id.*

104. There are some exceptions where, because of special knowledge or experience, a person should not be classified as an outside director. These may include legal counsel, the corporation's banker, retired executives of the corporation, or representatives of major corporate suppliers or customers. 282 N.W.2d at 652, *citing* KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 25 (3d ed. 1978) [hereinafter cited as KNEPPER].

105. 282 N.W.2d at 652, *citing* Leech & Mundheim, *The Outside Director of the Publically Held Corporation*, 31 BUS. LAW 1799, 1805 (1976) [hereinafter cited as Leech].

106. 282 N.W.2d at 653.

107. KNEPPER, *supra* note 104, at 26.

108. *Id.* at 26-27.

109. Winter, *supra* note 19, at 285.

110. 8 U. BALT. L. REV. 341, 352 (1979).

111. *See* Swinney v. Keebler, 480 F.2d 573 (4th Cir. 1973) (dictum); Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (E.D. Pa. 1940); Gerdes v. Reynolds, ___ Misc. 2d ___, 28 N.Y.S.2d 622 (Sup. Ct. 1941). The courts have singled out the size of the premium paid for control as putting the seller of control of the corporation on at least inquiry notice that the purchaser had looting on his mind. Failure to investigate results in the sellers being accountable for the premium received.

Where the assets, however, were neither easily soluble nor highly liquid, but instead consisted of real estate and chattel mortgages, then notice of looting was less likely to be imputed to the seller-controller. Harman v. Willbern, 374 F. Supp. 1149 (D. Kan.), *aff'd*, 520 F.2d 1333 (10th Cir. 1975) (distinguishing Insuranshares and Gerdes).

*shares Corp. v. Nothern Fiscal Corp.*,[112] where the circumstances surrounding the payment of an inflated price for corporate stock was held to impose a duty of investigation upon the directors.[113] Unless an adequate investigation was undertaken to convince a reasonable person that no fraud was intended or likely to result, such circumstances would put a prudent man on guard and awaken suspicion.[114] In a similar case, where the sale of the majority's share was declared invalid, a sale price greatly in excess of the stock's value was held sufficient to alert the directors.[115]

In *Rowen v. LeMars Mutual Insurance Co.*, the plaintiffs argued that Iowa Mutual's outside directors should have been alerted by the substantial purchase price of the Alesch, Inc.-Iowa Mutual transaction.[116] However, the court found that the circumstances were not enough to arouse the Iowa Mutual directors' suspicions. The outside directors were told that the transaction was an advantageous deal for Iowa Mutual.[117] Therefore, the Iowa Mutual "outsiders" had no duty to make an independent investigation concerning the valuation of Alesch, Inc.[118]

The *Rowen* court did not say that the outside directors had no duty except to their own corporation. Rather, it said that the corporation must be their prime concern.[119] The outside directors could not abdicate their duties, nor "close their eyes" to the conduct of corporate affairs.[120] However, if they found nothing amiss, the "outsiders" would not be held liable for breach of a duty to investigate.[121]

On the other hand, circumstances concerning the directors at LeMars Mutual were entirely different and the court made no attempt to distinguish between outside or inside directors' roles. The LeMars Mutual directors, unlike the Iowa Mutual directors, were faced with questionable conduct directly affecting their own corporation.[122] The court relied heavily upon facts like the excessive purchase price of Alesch, Inc. and the *en masse* resignation of LeMars Mutual's board[123] to find that there was a duty to inquire

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112. 35 F. Supp. 22 (E.D. Pa. 1940).

113. *Id.* at 27.

114. *Id.* at 25. *See also* Greene v. Emersons, Ltd., 545 SEC. REG. & L. REP. (BNA) A-7 (1980) (in light of the limited duty of outside directors to purchasers of the company's stock, there is no violation of rule 10b-5 without "something closer to an actual fraud . . .").

115. Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. 1941).

116. 282 N.W.2d at 653.

117. *Id.*

118. *Id. See also* Proksch v. Bettendorf, 218 Iowa 1376, 257 N.W. 383 (1934); Cornick v. Weir, 212 Iowa 715, 237 N.W. 245 (1931).

119. 282 N.W.2d at 653.

120. *Id. See also* Harman v. Willbern, 374 F. Supp. 1149, 1157 (D. Kan. 1974), *aff'd*, 520 F.2d 1333 (10th Cir. 1975); Heit v. Bixby, 276 F. Supp. 217, 231 (E.D. Mo. 1967).

121. 282 N.W.2d at 653.

122. *Id.* at 653-54.

123. The request for *en masse* resignation, was prepared and submitted to the LeMars Mutual board for their signatures, as part of the overall plan by which John Alesch would retire

and investigate on the part of all of the LeMars Mutual directors.[124] These directors could not escape the consequences of their breach of fiduciary duties where the corporate victim, LeMars Mutual, had a right to expect its directors to be more vigilent.[125] Even ordinary diligence[126] on the part of the LeMars Mutual directors would have prevented the surrender of the corporation.[127]

Theoretically, there are at least three possible standards for invoking a seller's duty to investigate: (1) no duty absent actual knowledge of a purchaser's wrongful intent; (2) a duty to investigate where circumstances suggest the likelihood of fraud; and (3) an absolute duty to investigate.[128] The standard adopted by the *Rowen* court was consistent with that adopted by other jurisdictions.[129] When there was a suspicion of a fraudulent transaction the fiduciary relationship required the sellers, the LeMars Mutual directors, to investigate the purchaser, Iowa Mutual, in order to reduce the likelihood of harm to the mutual insurance company and the policyholders.[130]

Problems regarding the sale of controlling interests in a corporation by fiduciaries have long concerned scholars, courts and, most recently, legislatures.[131] Following the Model Business Corporations Act, Iowa has enacted statutory provisions concerning the duties of the corporate or insurance agency director.[132] Ironically, the statutory language is noticeably absent from the *Rowen* court's decision. Such an omission can only foster uncertainty as to the ultimate impact of the *Rowen* decision on future sale of control litigation.

Overall, there is the concern that persons qualified to serve as corporate

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from LeMars Mutual and at the same time sell his agency. *Id.* at 654.

124. *Id.*

125. *Id.*

126. "Diligence" involves the taking of normal precautions. If a danger is readily discernable and voidable, the court as a matter of law may hold a party to perceive and remedy it in some fashion, just as the jury may do as a matter of fact. 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 17.1 at 970 (1956) [hereinafter cited as HARPER].

127. 282 N.W.2d at 654.

128. 8 U. BALT. L. REV. 341, 347 (1979).

129. *See, e.g.*, Swinney v. Keebler Co., 480 F.2d 573 (4th Cir. 1973); McDaniel v. Painter, 418 F.2d 545 (10th Cir. 1969); Harman v. Willbern, 374 F. Supp. 1149 (D. Kan. 1974), *aff'd*, 520 F.2d 1933 (10th Cir. 1975); Gerdes v. Reynolds, 28 N.Y.S.2d 622 (1941); Tryon v. Smith, 191 Ore. 172, 229 P.2d 251 (1951).

130. 282 N.W.2d at 654. *See also* Claggett v. Hutchinson, 583 F.2d 1259 (4th Cir. 1978).

131. Hazen, *supra* note 59, at 265.

132. The Iowa Code provides in part that:

> A director shall perform the duties of a director, including the duties as a member of any committee of the board upon which such director may serve, in good faith, in a manner such director reasonably believes to be in the best interests of the corporation, and with such care as on ordinary prudent person in a like position would use under similar circumstances.

IOWA CODE § 496A.34 (1979). *See also* ABA-ALI MODEL BUS. CORP. ACT § 35 (rev. ed. 1976).

directors will hesitate accepting corporate directorships if the duties imposed upon them become too great. Under the Iowa Code there is a question of whether directors who acted in "good faith and in a manner [they] believed to be in or not opposed to the best interests of the corporation," could seek indemnification from the corporation.[133] In many respects, *The Wall Street Journal* may have foreshadowed the possible ramifications of the *Rowen* opinion when it reported that: "Scores of men are politely declining offers they once would have jumped at to serve on prestigious boards . . . there now is a real shortage of competent men willing and able to serve as directors."[134]

Perhaps the most immediate impact of the *Rowen* decision will be on corporate attorney roles and whether members of the Bar owe a higher duty of loyalty and due care to the corporations than was previously recognized in Iowa. Continuing its systematic application of the corporate defendants' facts and duties, the Iowa Supreme Court found that LeMars Mutual's non-director attorney, Burton Dull, breached his fiduciary duties to the corporation because of his active participation in the transaction from its inception.[135]

Although Dull contended that he was only a "bystander" and had no input in the suspect transaction, the court found that the facts did not sup-

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133. IOWA CODE § 496A.4(19)(a) (1979) provides as follows:

(19) To make indemnification to the following extent and under the following circumstances: (a) to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust or enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit, or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit, or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

The enactment of statutes permitting indemnification by legislative bodies is a demonstration of the legislature's need to provide protection for aggressive corporate managers willing to undertake good faith risks in the search for profits. It is important to note that most states distinguish between derivative actions and third party actions. Also, there is a trend to follow section 5 of the Model Business Corporation Act, which restricts indemnification to cases where the director acted in good faith and in a manner he believed to be in the best interests of the corporation. *See* KNEPPER, *supra* note 104, at 592-93.

134. *The Wall Street Journal*, March 13, at 1, col. 6 (1978).

135. 282 N.W.2d at 655.

port this contention.[136] Dull was instrumental in the negotiations leading up to the sale of Alesch, Inc.[137] The court found that Dull knew that the Alesch, Inc.-Iowa Mutual deal was contingent on the resignation of the LeMars Mutual directors.[138] He also knew that the purchase price of Alesch, Inc. exceeded the value of its stock, that it was unprecedented to award pensions to the retiring directors and that extraordinary favors were given to members of the Alesch family, Alesch, Inc. and LeMars Mutual.[139] The most damaging evidence against Dull was a letter he wrote to one of the inside directors at Iowa Mutual.[140] In the letter Dull referred to the management contract under which LeMars Mutual could pay Alesch, Inc. $2,500.00 per month as "management fees" through which Iowa Mutual could "recoup its investment."[141] Thus, LeMars Mutual, not Iowa Mutual, would be paying for the Alesch, Inc. stock.[142]

In derivative actions, the ethical consideration of corporate legal counsel have become a quagmire of competing interests and rules.[143] The combination of conflicting interests of plaintiff policyholders, corporate executive defendants, and nominal corporation defendants, coupled with the court's strict enforcement of the Code of Professional Responsibility, presents the attorney with a dilemma.[144] The question for the attorney becomes, "Who is [my] client?" or more precisely, "Who speaks for the client?"[145]

One writer has suggested that the corporate attorney serves two clients: the corporate official or employee who is dealt with personally, and the ultimate client, the corporation itself.[146] The problem is further compounded by

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136. *Id.*

137. *Id. See* Brennan v. Midwestern United Life Ins. Co., 417 F.2d 147, *cert. denied*, 397 U.S. 989 (1970). A corporation was held liable for "aiding and abetting" a broker's violation of rule 10b-5 where the corporation's officers knew that the broker was making misrepresentations but failed to take action to prevent or disclose these improper activities.

138. *Id.*

139. *Id.*

140. *Id.* at 656.

141. *Id.* The letter from Dull read in part:

> I have not and will not attempt to prepare the agreement between the Alesch Agency and LeMars until after we have had an opportunity of discussing this matter further. The provisions of this contract, of course, will be the means of [Iowa Mutual's] method of recouping its payment to the owners of the stock of the Alesch Agency.
>
> [I]t appears to me that everything is shaping up just as we anticipated and I am sure that this venture can and will be advantageous and profitable to all parties.

Record, vol. 5, at 2904, Rowen v. LeMars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979).

142. 282 N.W.2d at 656.

143. Newman, *Former Corporate Counsel and Client Confidences in a Derivative Action*, 4 J. CORP. L. 321, 323 (1979) [hereinafter cited as Newman].

144. *See generally id.*

145. *Id.* at 331. *See also* Marsh, *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1227 (special issue 1978) [hereinafter cited as Marsh].

146. KNEPPER, *supra* note 104, at 419.

the ABA's Code of Professional Responsibility, which states that the lawyer employed by a corporation owes an allegiance to the entity and not to one individual connected with the entity.[147] The difficulty for Dull was that his interests were spread too thin.[148] "No man can serve two masters."[149] Dull was not only representing the corporate victim, its policyholders, and the perpetrators of the illegal transaction, but he was also slated to become a LeMars director as well.[150]

The likelihood of conflicts of interest increase when lawyers serve as corporate directors,[151] thus imposing upon them a higher duty of loyalty and due care because of their special skills and increased involvement in the corporation.[152] The *Rowen* court, however, did not rely upon Dull's position as an uncaring director to determine his liability. Dull was held to a higher standard of care solely in his capacity as an attorney.[153] Such a conflict of interest arising out of simultaneous representation of two or more conflicting clients violates a lawyer's duty of undivided loyalty.[154]

Arguably, there does exist an obligation on the part of the lawyer to prevent the corporate client from acting outside the bounds of the law.[155] The problem, however, is that it is not always as easy to define an entity's interest as it is to define the interests of directors, officers, employees or stockholders.[156] The corporation is an artificial, invisible being and it is difficult to identify any interest which the corporation has, if it were divorced entirely from all of its human participants.[157] Nevertheless, the attorney is told that the entity is owed a duty. Pragmatically, the lawyer is employed by the management of the corporation. It is they whom the lawyer advises, and, short of clear-cut fraud or gross over-reaching, management is the immediate client.[158] The attorney may work for management, but management's fiduciary duties run to the stockholders and so the theory goes that the attorney's duties run to the stockholders.[159]

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147. *See ABA Code of Professional Responsibility*, EC 5-18 (1969) [hereinafter cited as *CRP*].

148. 282 N.W.2d at 655.

149. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 8 (1934).

150. 282 N.W.2d at 655.

151. KNEPPER, supra note 104, at 425.

152. Harris, *The Case for the Lawyer-Director, in Lawyers as Directors-A Panel Discussion*, 30 BUS. LAW 41 (1975) [hereinafter cited as Harris].

153. 282 N.W.2d at 654.

154. KNEEPER, *supra* note 104, at 425.

155. Gruenbaum, *Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors, and National Student Marketing Corp.*, 54 NOTRE DAME LAW. 795, 815 (June 1979) [hereinafter cited as Gruenbaum].

156. KNEPPER, *supra* note 104, at 423.

157. Marsh, *supra* note 145, at 1228.

158. Riger, *The Lawyer-Director—"A Vexing Problem,"* 33 BUS. LAW 2381, 2384 (special issue 1978).

159. Newman, *supra* note 143, at 332.

Although the *Rowen* court failed to cite any supporting case law for its decision to hold Dull liable, the final outcome was not inconsistent with similar proceedings in other jurisdictions. In a recent Nebraska Supreme Court decision,[160] the court implied that if a lawyer-director failed to exercise the duties he owed to a mutual insurance company, the attorney could not be dismissed from the suit.[161] In a similar case, where the attorney should have known that he was required to make a reasonable investigation of the truth in a document's statements, the court found that failure to make such an investigation did not give the attorney reasonable ground to believe the statements were true and liability ensued.[162]

In an SEC proceeding where securities lawyers had violated their professional responsibilities with respect to all concerned, the attorney was held liable for breach of a duty to disclose.[163] The administrative law judge implied that the lawyers had to disclose the alleged misstatements and omissions to the shareholders and to the investing public if the board of directors, after being advised, did not.[164] As a matter of law, once the lawyers were put on notice of the directors' violations, the attorneys should have embarked on some course of action which would have prevented the violation from occurring.[165]

In *Rowen*, Dull did nothing to fulfill his fiduciary duties to the corporation. Dull was liable for his active assistance in bringing the illegal plan to fruition and in failing to advise the LeMars Mutual board of the details of the transaction by which Iowa Mutual would take over control.[166]

As an alternative, the *Rowen* court could have reached its final conclusion by refering to the Code of Professional Responsibility. The court's conclusion was not contrary to EC 5-18,[167] especially when it suggested that a lawyer retained by a corporation had a responsibility to the corporation and ultimately to its policyholders.[168] While a corporation's board management should be given considerable leeway in making "business judgments,"[169] in the end, the corporation and, therefore, its board and its management are accountable to the corporation's shareholders.[170] Dull's liability was pre-

160. Doyle v. Union Ins. Co., 202 Neb. 599, 277 N.W.2d 36 (1979).

161. *Id.* at 42-44.

162. Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544 (E.D.N.Y. 1971).

163. In re Carter, SEC. REG. & L. REP. (BNA) no. 494, F-1 (Mar. 14, 1979).

164. *Id.*

165. *Id.*

166. 282 N.W.2d at 655-56.

167. EC 5-18 provides: "A lawyer employed or retired by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity."

168. Gruenbaum, *supra* note 155, at 812.

169. Under the "business judgment rule" informed directors will not be held liable to the corporation for their honest mistakes, *e.g.*, Bodell v. General Gas and Electric Co., 15 Del. Ch. 420, 140 A. 264, 267 (1927).

170. Gruenbaum, *supra* note 155, at 812.

mised on his failure to fully advise the LeMars board of the sale details by which Iowa Mutual was to take over control.[171] At a minimum, Dull owed a duty to his client, LeMars Mutual, to inform them of the transaction's consequences.[172]

Therefore, under the guise of the *Rowen* opinion, the Iowa Supreme Court has implied that it is the legal professions' responsibility to society[173] to disclose what they perceive as the consequences of their corporate client's conduct to those shareholders.[174] They have a duty to determine who their client is and to represent their client with genuine loyalty. The obligation to the interests of the client also dictates that the attorneys be cognizant of their client's responsibilities to others.[175] Should attorneys be motivated by their own self-interests of share the self-seeking motives of their clients, they will be held personally liable. Like joint venturers, trustees, shareholders and inside directors, attorneys are held to "something stricter than the morals of the market place."[176] As corporate fiduciaries, they must walk, at least in the eyes of the Iowa Supreme Court, at a level higher than that trodden by the crowd.[177]

Nonetheless, the question remains whether the Iowa Supreme Court has sufficiently defined the corporate attorney's fiduciary duties, or whether the duties existed beyond the *Rowen* boundaries. When corporate counsel gives advice that management rejects, what is counsel's duty? Does counsel have a duty to inform outside directors, the investors, or the authorities? It remains uncertain whether the attorney has a duty to "blow the whistle"[178] on his corporate client once he learns of the client's questionable conduct. Finally, whether corporate counsel will be liable for all of their client's conduct because of the higher duty imposed upon them by the *Rowen* court is, as yet, unanswered.

Several years ago, it was lamented that a "meandering" path of law governed control-related transactions.[179] "[T]oday's path may be longer and

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171. 282 N.W.2d at 655.

172. *Id.*

173. *ABA Code of Professional Responsibility*, Preamble. It may be that a lawyer's responsibility to society as envisioned by the CPR makes it inappropriate to limit his obligations to the client's shareholders in the case of a corporate client. There may be an obligation to recognize and consider the interests of the public at large. *See* Gruenbaum, *supra* note 155, at 802 n.31.

174. *Id.* Gruenbaum, *supra* note 155, at 802.

175. *Id.* at 799.

176. Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

177. *Id.*

178. *See* Gruenbaum, *supra* note 155, at 810. In SEC v. National Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978), the SEC's position that lawyers have a duty to "blow the whistle" on their clients was considered repugnant to the unquestioned principle of devotion and loyalty to the client, and contrary to the obligation to maintain the client's confidences and secrets.

179. Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1, 38 (1956).

wider, but it is no less tortuous."[180] Whether the *Rowen* standard of active conspiracy, duties of loyalty and due care, and distinctions between inside and outside directors applies to sale of control cases not involving mutual inurance companies or such an egregious set of circumstances, remains unsettled. Consequently, in clearing a path on which corporate ficudiaries must trod, the *Rowen* court may have opened a litigation thoroughfare of unanswered questions and uneasiness for those serving as corporate directors and attorneys.

*Nan M. Horvat*

180. Hazen—U. Pa. L. Rev., *supra* note 73, at 1066.