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How good a case do the Koches have in the Cato flap?

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By now you've probably heard that the billionaire, Tea Party-funding Koch brothers are attempting to regain control of Cato Institute, the non-profit libertarian think tank Charles Koch cofounded in 1974. The Koch v. Cato kerfuffle has generated so much heat that we decided to take a close look at the legal argument underpinning the takeover attempt.

The (alleged) facts come courtesy of a complaint Charles and David Koch filed Thursday in state court in Johnson County, Kansas. The suit claims that under Cato's "shareholder" agreement, the shares once held by the late William Niskanen must be offered first to the institute and then, if Cato chooses not to purchase them, to the remaining Cato shareholders. Niskanen, a former chief economist for Ford Motor Company and a member of President Ronald Reagan's Council of Economic Advisors, did not specifically mention the shares in his will, but they would be wrapped up in the residual distribution of his estate; his spouse Kathryn Washburn is personal representative of the estate.

The suit, which also names Washburn and original Cato shareholder and current president Ed Crane as defendants in the suit, seeks a declaration that Washburn cannot simply transfer the Niskanen shares to herself or any other heir but must comply with the shareholder agreement. (Slate's Matthew Yglesias has agood explanation of why a non-profit has "shares"; according to him, the Cato shares are akin to membership stakes.) If the Koches gain control of Niskanen's Cato shares they will effectively win control of the institute, since they each have 25 percent stakes already.

So how strong a case do they have? The suit is primarily based on Section 3 of the Cato shareholder agreement, which was signed in 1977 (and is attached to the complaint). The relevant section provides that "[n]o stockholder of the corporation shall have the right or power to pledge, hypothecate, sell, or otherwise dispose of, directly or indirectly, all of any part of his shares of stock without first offering to sell such shares ... to the corporation." That's pretty clear about how shares are to be handled if a direct owner wants out -- but it doesn't specifically address what happens when a shareholder dies.

That could turn out to be a key point for the defense, according to Edwin Hecker, a professor of business associations at The University of Kansas School of Law. Case law in Kansas, he said, holds that restrictions on the transferability of corporate shares are strictly construed. If transfers such as those made upon death are not explicitly addressed in a shareholder agreement, Hecker said, "You have to have a pretty strong case that it was intended to be covered." What's more, he said the language of the agreement, which says shareholders may "otherwise dispose of" shares could be read to refer to situations involving shares being exchanged for money or other collateral, rather than passing to heirs.

Hecker also said the Koches may be making an inferential leap in asserting that if Cato does not purchase Niskanen's shares, they have a right to acquire them. The agreement, he noted, says only that, "[s]hould the rights granted hereunder to the corporation be deemed inconsistent with its corporate purposes," then those rights "shall be deemed granted to the shareholders." It's not spelled out in the shareholder agreement that a decision by Cato not to purchase a stakeholder's shares is "inconsistent with its corporate purposes," and triggers the "right of repurchase" for other shareholders.

On the other hand, Hecker said, the shareholder agreement and its subsequent amendments do seem intended to vest tight control of Cato in the hands of the original shareholders. That could weigh in the Koch brothers' favor.

Cato has indicated it does not intend to go quietly. "Mr. Koch's actions in Kansas court yesterday represent an effort by him to transform Cato from an independent, nonpartisan research organization into a political entity that might better support his partisan agenda," Crane said in a statement. "We view Mr. Koch's actions as an attempt at a hostile takeover, and intend to fight it vehemently in order to continue as an independent research organization, advocating for individual liberty, limited government, free markets and peace." (Cato didn't tell us who will be defending the institute in the litigation.)

The Koch brothers are represented by **Stinson Morrison Hecker** (no connection to Prof. Edwin Hecker). **Daniel Crabtree**, the partner handling the case, did not immediately respond to a request for comment. In a statement cited by the New Yorker magazine's website, Charles Koch denied this is a hostile takeover and instead said, in part, "All we seek is adherence to the shareholders' agreement."

Niskanen's will leaves little doubt the Cato remained an important part of his life. After some specific bequests, including $2,000 for the care of his dog, he left one third of his estate to Washburn, one third to Cato, and one third to the Institute for Justice, a libertarian, public interest law firm.

(Reporting by Erin Geiger Smith)