

Business Associations II, Simulation 4
Closely-held Corporations (Gucci)

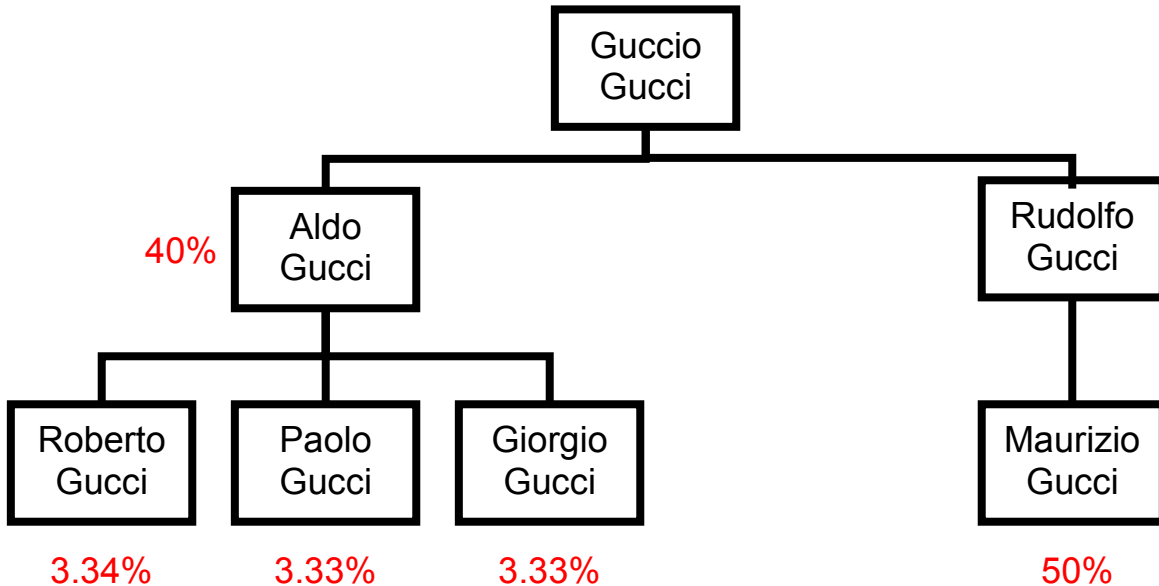
Note: The attached articles are real, but the additional “facts” in this simulation fact pattern weave fact and fiction and are not intended to represent real events.

From: Ben I. Graham [mailto:Mr.BIG@work.com]
Sent: Tuesday, March 27, 2009 3:15 PM
To: Project Backstab Mailing List
Subject: CONFIDENTIAL – Project Backstab

Team:

You’ve been assigned to work with me on Project Backstab. Our clients are Aldo Gucci and two of his three sons, Roberto and Giorgio. Together they own 46.67% of Gucci, a Delaware corporation that owns several luxury brands (particularly fashion and perfume). Gucci has only five shareholders, but has not opted to become a statutory close corporation. We have been retained to help find a way for our clients to seize control of Gucci.

Gucci’s shareholders: I asked a paralegal to find and attach to the end of this e-mail two articles that will give you some background to the history of family feuding in Gucci (one article is from the Economist, a second is a book review from the Wall Street Journal). [Note: this simulation will take place in December 1985, after Maurizio took control of Gucci and before he was murdered; however, current laws (rather than 1985 laws) apply, and applicable law is Delaware law.] The paralegal also created a Gucci family tree, complete with current share ownership:



Control of Gucci: Gucci's largest shareholder (owning 50% of the shares) is Maurizio. He has allied himself with Paolo to form a coalition controlling 53.33% of Gucci; our clients own the remaining 46.67%. Gucci's board is composed of five directors, and is elected by cumulative voting. Three of them were appointed by Maurizio's faction: Maurizio, Paolo, and Niccolo ("Nick") Machiavelli (a childhood friend of Maurizio's). The other two directors, appointed by the votes of our clients, are Aldo and Roberto.

Our clients want to seize control of Gucci. With a minority of shares and of boards seats, this would seem impossible. However, our clients informed us that Nick has been persuaded that Maurizio's management abilities are sub-par and that his strategy for the company's development is foolish. So, Nick now secretly supports Aldo's faction. However, if Maurizio learns about Nick's change of heart, he will likely try to replace him with another director, taking away Aldo's chance to control Gucci. Maurizio and Paolo together still own a majority of Gucci's shares.

I'd like you to find a way to use Aldo's secret majority on the board to take over Gucci (i.e., give Aldo, Roberto and Giorgio a total stake of more than 50% of Gucci's shares). Let me know when you've figured out a way.

BIG

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Family frictions

The Economist, Mar 6, 2004, p. 7

A question of inheritance

These days the Gucci brand stands for high-quality handbags, well-crafted shoes, elegant fashion, a supposedly "erotic" perfume called Envy for Men, and even wallpaper (complete with the "double G" logo). Yet a decade ago the image was one of financial battles, family feuds and murder, a combination mercifully rare even in the emotional world of high fashion.

The Gucci story begins in 1921, when Guccio Gucci opened a small leather-goods shop and saddlery in Florence. The domineering Guccio had five sons and one daughter, who in turn had children. After Guccio died in 1953, his son Aldo, inventor of the famous double G logo, started the transformation of the family business into a global brand, with Queen Elizabeth II and Grace Kelly as early fans.

Success increasingly brought family discord, with fist fights in the Gucci boardroom of the 1980s. Aldo and his brother Rodolfo wanted to limit Gucci products to Gucci shops; Aldo's son Paolo decided otherwise, and soon the Gucci logo was on everything from headscarves to keyrings. At a board meeting in 1982 Paolo was hit by a tape-recorder thrown by--the family history is fuzzy on this point--either his father or his uncle or Rodolfo's son, Maurizio. In response, he alerted the American authorities to his father's tax evasion. This led to a jail term for Aldo, and to the sacking of Paolo from the Gucci board. He set up a rival firm that collapsed in 1994, a year before his death.

More drama was to come. Maurizio, who in 1972 had angered his father by marrying the socially less elevated Patrizia, nonetheless inherited 50% of Gucci when his father died in 1983. He proceeded to force uncle Aldo from the board, and two years later jettisoned Patrizia. Her revenge came a decade later when Maurizio announced plans to remarry; he was shot dead in 1995 by a hitman hired by his ex-wife.

Enter the professionals

That the brand has survived the family is a tribute to the work of two Americans, Tom Ford and the Italian-born Domenico De Sole. Mr. De Sole had joined Gucci in 1984 as boss of its American operations and was well aware of the family nightmare ("Each member of the Gucci family would have his idea, and what came out was a monster."). His move to Italy a decade later came as Maurizio was selling his half of the business to the Bahrain-based Investcorp, which had already acquired the half belonging to Aldo and his sons in the late 1980s. When Investcorp floated the company on the Amsterdam and New York exchanges in 1995 and 1996, Mr. De Sole was at last able to run Gucci properly.

Crucially, Mr. De Sole nurtured the talent of Tom Ford, who had joined Gucci in 1990 and had become its overall creative director by 1994. Together they transformed the company, increasing its revenues by 32% a year between 1994 and 2002, and forming the Gucci Group with the acquisition of labels such as Yves Saint Laurent, Boucheron, Balenciaga and Alexander McQueen. They even managed to fight off a bid in 1999 from the fearsome Mr. Arnault by enlisting Francois Pinault as a white knight. By 2001, Mr. Pinault's PPR had acquired 54% of the Gucci Group and Mr. Arnault admitted defeat. By the end of next month PPR, which now owns 68% of the Gucci Group, is obliged to make an offer for all the shares it does not own already.

And the reward for Messrs De Sole and Ford for rescuing the Gucci brand from the brink of bankruptcy? They will leave the group at the end of April because PPR has insisted on the final say in business decisions. But if they leave with sadness, at least they leave rich: Mr. De Sole, for example, in January cashed in a third of his stock options and made a profit of \$25m.

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THE WALL STREET JOURNAL.

'The House of Gucci' Shows the Rag Trade Can Really Be Murder – Family of Machiavellian Fashionistas Built Empire on Legal Antics, Bad Behavior – and Bad Taste

By Daniel Akst, Wall Street Journal, Sept. 1, 2000, p. W1

It's a rule of thumb in business that the more glamorous the industry -- and the further its products get from life's bare essentials -- the more miserably everyone involved seems to behave. Does the company make sheet-metal screws in Ft. Wayne, Ind.? What a bunch of nice folks. Do they make feature films in Los Angeles? Better brush up on your Machiavelli.

Doubters of this principle should immediately consult "The House of Gucci," Sara Gay Forden's exhaustive and gossipy account of the Gucci family's self-inflicted tribulations in running (and ultimately losing) its renowned luxury-goods business. Even by the Borgia-like standards of the fashion industry, the operatic Guccis were special. Not content with the usual familial stew of love, jealousy and greed, they added tax evasion, bigamy and, yes, even murder to the mix.

But perhaps the most remarkable thing about the Guccis was the family's astonishingly bad taste. Despite their grand pretensions ("We are not businessmen, we are poets!" Aldo Gucci once told an interviewer), their personal style was crass and their behavior often appalling. Gucci stores aspired to be temples of exclusivity, and they came close to succeeding; at one point New York magazine used its cover to proclaim Gucci's the city's rudest store. But for all the talk of quality and elegance, the firm that once specialized in fine hand-made leather goods was happy during the 1980s to cheapen its name by flogging canvas tote bags covered with its logo at retail outlets all over the world.

The Gucci empire was started in 1921 by former dishwasher Guccio Gucci and his wife, Aida, who opened their first store in Florence. But it was their son Aldo who built the Gucci brand into a global snob-appeal powerhouse, extending it first to the rest of Europe and then to the great green breast of the New World. Aldo, who died in 1990, was a dynamo, by turns paternalistic and tyrannical.

He wasn't the only one of the founders' offspring with an interest in the business, however, and after 1974, when his brother Vasco died, Aldo shared ownership with his surviving brother, Rodolfo, a minor star of silent films who never managed the transition to talkies. Aldo resented his brother's 50% share, which was out of all proportion to his contribution to the company, and began trying to funnel profits through a perfume subsidiary that he and his sons controlled.

The family business soon devolved into a network of ever-shifting alliances and betrayals, obscure legal arrangements and, often, open warfare. Aldo's son Paolo, for instance, unhappy with his role in the company, was determined to start his own Gucci brand but was blocked at every turn by his father and uncle, who sued him and warned suppliers that casting their lot with Paolo would cost them Gucci business. In retaliation,

Paolo ratted on his father's colossal tax evasion over the years -- with the result that the elder Gucci, already in his 80s, went to prison. Despite the bitterness of their feud, the father helped the son financially (from behind bars!), although the epic litigation ruined Paolo, who died penniless.

All that is nothing compared to the saga of Paolo's cousin Maurizio, who managed to unify the business under his own hand only to prove that he lacked the most basic management skills to keep it afloat. ("He became like a seat cushion that takes the shape of the last person to sit on it," his wife complained.) Thus did ownership of the Gucci enterprise -- and the Gucci name that was probably its biggest asset -- pass into the hands of a private investment firm and, ultimately, the stockholding public.

The disappointment of losing the venerable family business (albeit in exchange for a gigantic payday) should have been Maurizio's biggest problem, but soon after letting go somebody gunned him down outside his office in Milan. It would be churlish to disclose here whodunit, since Ms. Forden saves the unwinding of this mystery until the end of her generally fascinating account. When something like justice was finally done, Gucci stores around the world displayed a pair of sterling-silver handcuffs in the window.

Where did Gucci get such a kinky sense of humor? Probably from the remarkable Tom Ford. Once Gucci was rid of all those Guccis, the company enjoyed a remarkable turnaround, thanks in large part to the designer Ford, who embraced Gucci's over-the-top style, infused it with sexuality and at the same time deflated its awful pomposity.

But successful fashion giants are generally two-headed monsters guided by a brilliant manager as well as a design genius, and judging from this book chief executive Domenico De Sole deserves just as much credit, if only for having the patience of Job. He not only turned Gucci around but against all odds fended off a hostile takeover by Bernard Arnault, the legendary head of LVMH Group, and even managed to acquire the grand French firm of Yves St. Laurent.

Ms. Forden's book dwells numbingly at times on the gross trappings of wealth and the dizzying minutiae of the Gucci family's legal battles, and her prose can be somewhat leaden. But all in all "The House of Gucci" is a penetrating chronicle of the rise and fall of a family business, one that shows clearly how even big, successful family firms often can't survive without professional management and outside capital -- and how the personalities of the founders' descendants can make selling not just prudent but inevitable.