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Melvin Aron Eisenberg

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Melvin Aron Eisenberg*

This Article will consider the rules that govern exchange transactions between a corporation and one or more of the corporation's directors or senior executives. I shall refer to these transactions as self-interested transactions, and I shall take as my text section 5.02 of the Tentative Draft of the ALI's PRINCIPLES OF CORPORATE GOVERNANCE.¹

In a well-known article, Harold Marsh pointed out that in the late nineteenth century, self-interested transactions were automatically voidable at the insistence of the corporation or its shareholders.² Perhaps the strongest reason given for this rule was that when a contract is made with a director,

the remaining directors are placed in the embarrassing and invidious position of having to pass upon, scrutinize and check the transactions and accounts of one of their own body, with whom they are associated on terms of equality in the general management of all the affairs of the corporation.³

By the early part of the twentieth century, the law had radically changed; self-interested transactions were no longer automatically voidable. The reason for the change seems to have been the perception that it might sometimes be advantageous for a corporation to engage in transactions with its directors or senior executives. Of course, in perfect markets involving only homogeneous goods, there would usually be no reason for a corporation to transact with a director or senior executive rather than transacting on the market. Given our rich market economy, even in imperfect markets involving differentiated goods there are probably few instances in which a director or senior executive can offer the corporation a commodity for which there is no good market substitute. Nevertheless, it is now accepted that the corporation may have a legitimate interest in contracting off the market. A director or senior executive might own a commodity for which there was no good market substitute, or might be willing to give better terms than could be obtained on the market. The question must then be faced: What rules should govern self-interested transactions once the rule of automatic voidability is rejected?

The duty of loyalty under corporate law is rooted in the duty of loyalty under agency law.⁴ In the classical agency paradigm, a single agent acts on

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¹ Professor of Law, University of California, Berkeley. A.B., 1956, Columbia; LL.B., 1959, Harvard. This Article is based on an inaugural lecture given at the University of Iowa in October of 1986. I thank Marshall Small and Jesse Choper for their comments.

² See RESTATEMENT (SECOND) OF EMPLOYMENT RELATIONS § 77 (1957).


⁴ See RESTATEMENT (SECOND) OF AGENCY § 387 (1957).
behalf of a single principal. In the case of the corporation, the situation is structurally more complex. For example, a senior executive who enters into a self-interested transaction may deal with a subordinate, an equal, a superior, the board, or the shareholders. These structural complexities introduce a number of complexities into the legal analysis, the most significant of which concern the effect of approval by disinterested directors or shareholders, and the special case of compensation. Before getting to these complexities, I will examine the simple case, in which the approval of disinterested directors or shareholders is not obtained, and compensation is not involved. Under section 5.02 of the Principles of Corporate Governance, this case is governed by a conjunctive test. The director or senior executive must make full disclosure (disclosure concerning the conflict of interest and the transaction) to the corporate decisionmaker who authorizes the transaction, and the transaction must be fair to the corporation.\(^5\)

Why is it not sufficient to employ a disjunctive test, which would be satisfied if either the director or senior executive makes full disclosure or the transaction is done at a fair price? It's pretty easy to see, in the simple case, that the director or senior executive often could not conceivably satisfy the duty of loyalty simply by making full disclosure. Suppose, for example, that the director or senior executive makes full disclosure only to a subordinate. To take another case, suppose a corporation has a board consisting of A, B, and C. A and B now enter into a self-interested transaction that is approved "by the board"—that is, by A and B—over C's objections. Clearly all the disclosure in the world by A and B to C should not make a dime's worth of difference if the transaction is unfair.\(^6\)

But why isn't fairness of price enough without full disclosure? There are several answers to this question. To begin with, in all areas of the law full disclosure must be made by persons who are in a relation of trust and confidence with those with whom they deal.\(^7\) This requirement reflects the expectations one has when he deals with those with whom he has such a relationship.

Moreover, a rule that fairness of price was enough without full disclosure would in effect remove decisionmaking from the corporation's hands and place it in the hands of the court. Many or most self-interested transactions involve differentiated commodities. Normally, one who purchases or sells a homogeneous commodity is a price-taker. If a commodity is homogeneous, it usually sells on

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5. Principles of Corporate Governance, supra note 1, §§ 5.02(a) (1), (2)(A). Section 5.02 does not use the term "full disclosure." Under section 1.09: A director ... [or] senior executive ... makes a 'disclosure concerning a conflict of interest' if he discloses to the corporate decisionmaker ... who authorizes or ratifies the transaction the material facts ... known to him concerning his conflict of interest .... A director ... [or] senior executive ... makes a 'disclosure concerning a transaction' if he discloses to the corporate decisionmaker who approves the transaction the material ... facts known to him concerning the transaction.


7. See, e.g., Restatement (Second) of Contracts § 161(d) (1981).
the open market at a single price that is set on an objective basis and is publicly known. A purchaser or seller must take that price if he wants to purchase or sell the commodity. In the case of commodities that are differentiated, however, prices are invariably negotiated. The market may set outside limits on the price—at some point, the price the seller demands is so high that the buyer would prefer a market substitute, or the price the buyer insists upon is so low that the seller would prefer to market his commodity to someone else—but within those limits the price will be indeterminable prior to negotiation. Therefore, if by a "fair price" we mean the price that would have been arrived at by a buyer and a seller dealing at arm's length, in the case of a self-interested transaction involving a differentiated commodity, a court attempting to determine whether the price was fair can do no more than to say that the price was or was not within the range at which parties dealing at arm's length would have concluded a deal. For example, a given office building might be fairly priced, in this sense, at anywhere from $40 million to $44 million, because any price within that range might have been arrived at by parties dealing at arm's length. Suppose that C Corporation purchases the office building for $42 million from a director or senior executive who has failed to disclose a material fact. The price may have been fair in the sense that third parties dealing at arm's length might have transacted at that price, but there is no way to know whether C would have paid $42 million if it had known the material fact. If there had been full disclosure, C might have agreed to purchase only at some price lower than $42 million.

Indeed, there is no way to know whether C would have purchased the building at all if the material fact had been disclosed. When a commodity is homogeneous, a purchaser will, by hypothesis, not prefer any member of the class—any grain of No. 2 red wheat—to any other. When a commodity is differentiated, however, each member of the class—each office building—differs from all other members of the class. A feature that one person prizes may be just what another would avoid, and the feature that was not disclosed might have been a deal breaker if it had been disclosed. Accordingly, if self-interested transactions were valid simply because the price was within the range of fairness, the corporation might end up with a commodity it would not have purchased if full disclosure had been made. This point is exemplified by Illustrations 2 and 4 to section 5.02:

2. X Corporation is seeking a new headquarters building. D, a vice president of X Corporation, owns all the stock of R Corporation, which owns an office building. D causes a real estate agent to offer R Corporation's building to X Corporation, but does not disclose his ownership of R Corporation. X Corporation's board of directors agrees to purchase the building for a fair price . . . . D has not fulfilled his duty to the corporation . . . .

4. The facts being otherwise as stated in Illustration 2, D discloses to X Corporation, prior to acquisition, his interest in R Corporation. D fails to disclose, however, that he has information, not

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8. Principles of Corporate Governance, supra note 1, at 32.
publicly available, that the State Highway Department has formally decided to run a highway through the property on which R Corporation's building stands, and to condemn the building under its power of eminent domain. The price paid by X Corporation is fair, even taking the proposed condemnation into account, since the condemnation award is likely to exceed the price . . . . D has not fulfilled his duty to the corporation . . . .

The argument is sometimes made that a distinction should be drawn between a failure to disclose a conflict of interest and a failure to disclose a material fact concerning the transaction itself. Under this argument, a failure to disclose a conflict of interest may be fatal, but a failure to disclose a material fact concerning the transaction should not be. The premise of the argument is that once the director or senior executive has disclosed his conflict of interest, the corporation is as much on guard as if it were dealing with a third party, and there is no need to require the director or senior executive to disclose more than a third party would have to. This premise is wrong. Knowing that a director or senior executive has an interest in an exchange transaction doesn't necessarily put the corporation on guard. When persons are in a relation of trust and confidence, they do not go on guard simply because they are dealing in an exchange context. If A sells his used car to his sister, she assumes that he will be forthcoming about the car in a way a stranger would not, even though she knows he has an interest in the transaction. The same is true of dealings between a director or senior executive and his colleagues.

Furthermore, even if the corporation was put on guard as a result of the disclosure of the conflict of interest, there would be an unfair informational disequilibrium between the parties unless the director or senior executive disclosed all material facts concerning the transaction. The director or senior executive knows, or at least is in a position to know, every material fact the corporation knows about the transaction. In order to level the playing field, the corporation should know every material fact the director or senior executive knows.

An argument sometimes made against the requirement of disclosure is that it's too tempting for a court to determine, in the light of hindsight, that an undisclosed fact was material. It's not clear how different this problem is from the difficulties that always arise in determining and evaluating past facts. In any event, section 5.02 addresses the problem by adopting the rule that the disclosure requirement is satisfied if, following a later make-good disclosure, the transaction is ratified by the board, the shareholders, or the corporate decisionmaker who initially approved the transaction. The transaction can still be attacked on the ground of unfairness. A later make-good disclosure, followed by ratification, cures only the original nondisclosure, not the lack of fairness.

9. Id.
10. Id. § 5.02(b).
11. The argument that it is too easy to say in hindsight that an undisclosed fact was material is also dealt with in the Comment to § 5.02. Under § 5.02, approval by the board shifts the burden of proof and changes the standard of proof only if there has been disclosure to the board at the time it gives its approval. PRINCIPLES OF CORPORATE GOVERNANCE, supra note 1, § 5.02(b). However,
Another reason why fairness of price is not always enough to uphold a self-interested transaction is that fairness is measured not only by price, but by process. This point has been well-stated by the Delaware court, in the context of examining fairness to minority stockholders:

The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.\(^\text{12}\)

So, for example, the comment to Restatement (Second) of Agency § 390 states that if an agent "is one upon whom the principal naturally would rely for advice, the fact that the agent discloses that he is acting as an adverse party does not relieve him from the duty of giving the principal impartial advice based upon a carefully formed judgment as to the principal's interest."\(^\text{13}\) This point is exemplified by Illustration 4:

P, a young physician with some inherited wealth and no business experience, places his property in charge of A to manage. Desiring a particular piece of land which represents a large share of P's assets, A waits until there is a slump in the price of land and, believing correctly that the slump is only temporary, suggests to P that it be sold, offering as an incentive that P's income from his profession will increase and that, although the price to be obtained is low, P can well afford to get more enjoyment from the proceeds now than from a larger amount later. P thereupon agrees to sell to A at a price which is as much as could be obtained at that time for the property. It may be found that A violated his duty of dealing fairly with P.\(^\text{14}\) (Emphasis added)

the Comment adds:

As a practical matter, it may sometimes be difficult to determine whether a given fact was or was not material. Accordingly, if a transaction was authorized in advance by disinterested directors and if the director or senior executive at that time disclosed his conflict of interest and all those facts that he in good faith believed were material to the transaction, and it later appears that the disclosure of material facts may not have been complete, then ratification of the transaction by disinterested directors, or by the disinterested superior, following the [required] disclosure . . . should be deemed to have a curative effect. Accordingly, in such a case the burden of proof will be on the party challenging the transaction, and that party will have to show that the transaction could not have been reasonably believed to be fair, just as if proper disclosure had been made at the time of the original authorization. Where disclosure of a conflict of interest . . . is made, this will be strong evidence that the director or senior executive acted in good faith.

\(\text{Id. Comment to § 5.02(a)(2)(B), at 40.}\)
\(\text{12. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).}\)
\(\text{13. Restatement (Second) of Agency, supra note 4, § 390, Comment c, at 210.}\)
\(\text{14. Id. § 390, Illustration 4, at 211.}\)
Unfairness of process may also be found where procedures are utilized that might be appropriate for dealing with third parties, but are inappropriate for self-dealing. This point is exemplified by Illustration 7 to section 5.02 of the Principles of Corporate Governance:

7. A, the chief executive officer of X Corporation, a real property development corporation, enters into a contract to sell a parcel of undeveloped real property to X Corporation for $500,000. The board of directors of X Corporation (consisting of A and two other directors who are not officers or employees of X Corporation) authorizes the transaction, with A not participating in the voting, relying on an appraisal of $500,000 supplied by an employee of X Corporation to support the fairness of the purchase price. The directors had also been supplied with an appraisal of an independent appraiser showing the property to have a fair value of $150,000. The transaction may be set aside, since the board could not properly rely on the appraisal of an employee of A (whose job security was subject to A's control) rather than on an independent appraiser, and therefore could not reasonably have believed the transaction to be fair, particularly in light of the value assigned to the property by an independent appraiser. If the transaction had been with an unrelated third party rather than A, the directors would not be required to utilize an independent appraiser, since no special procedures would have been required to protect X Corporation.15

So much for the simple case. Suppose now that a self-interested transaction is approved by disinterested directors. Should such approval insulate a self-interested transaction from the application of a fairness test? Certainly, such approval would not affect the obligation to make full disclosure: approval of a self-interested transaction without the benefit of full disclosure is meaningless. The real question, therefore, is whether a self-interested transaction that has been approved by disinterested directors after full disclosure will still be subject to a test of fairness, or will simply be treated like a third-party transaction.

There are two reasons why such a transaction should be subject to some sort of fairness test. First, directors, by virtue of their collegial relationships, are unlikely to treat one of their number with the degree of wariness with which they would approach a transaction with a third party. Second, it is difficult if not impossible to utilize a legal definition of disinterestedness in corporate law that corresponds with factual disinterestedness. A factually disinterested director would be one who had no significant relationship of any kind with either the subject matter of the self-interested transaction, or the director or senior executive who is engaging in the transaction, that would be likely to affect his judgment. It would, in short, be the disinterestedness we would expect from a fair-minded judge who is asked to recuse himself. For example, if a judge was the long-time friend of a party, the best man at his wedding, and the godfather of his child, we would expect him to recuse himself if he was fair-minded. For corporate-

15. Principles of Corporate Governance, supra note 1, Comment to § 5.02(a)(2)(B), at 38.
law purposes, however, it is desirable to define interestedness to include only financial and close familial relationships, because a corporate-law definition of disinterestedness that turned on factual disinterestedness would infect the business judgment rule. That rule protects only directors who are disinterested.\textsuperscript{16} If the corporate-law definition of disinterestedness corresponded to factual disinterestedness, the protection of the business judgment rule would be undesirably withheld from some directors who had no financial or close familial ties to a party to a transaction.

In practice, therefore, disinterestedness is defined in an artificially narrow way for corporate-law purposes. For example, under section 1.18 of the \textsc{Principles of Corporate Governance}, a director or officer is "interested" in a transaction only if he "has a pecuniary interest in the transaction, or . . . [he] has a financial or familial relationship . . . [to] a party to the transaction, that . . . is sufficiently substantial that it would reasonably be expected to affect [his] judgment with respect to the transaction in a manner adverse to the corporation."\textsuperscript{17} But since the corporate-law definition of disinterestedness is narrower than true disinterestedness, the law must require a fairness review of self-interested transactions even if they have been approved by "disinterested" directors, because directors who are "disinterested" under the corporate-law definition may not be disinterested in fact.

There is another way in which this can be put: A review of the fairness of price of a self-interested transaction may be thought of as a surrogate for a review of the fairness of process by which the transaction was approved. If we lived in a world of perfect information, a court could always determine, by direct means, whether directors who approved a self-interested transaction were truly disinterested, approached the transaction with that degree of wariness with which they would approach transactions with third parties, were given appropriate counsel by the interested director or senior executive, and so forth. Because we don't live in such a world, the courts may need to make these determinations by indirect means. If a self-interested transaction that has been approved by "disinterested" directors is substantively unfair, it can normally be inferred that either the approving directors were not truly disinterested, or that they were not as wary as they should have been because they were dealing with a colleague.

Substantive unfairness may give rise to another important inference. It may suggest that even if the self-interested director or senior executive made full disclosure of all material facts, he withheld the counsel that he would have given if the transaction had been with a third party.

The implications as to process that can be drawn from substantive unfairness are nicely illustrated by Justice Cordozo's well-known opinion in \textit{Globe Woolen v. Utica Gas & Electric Co.}\textsuperscript{18} Globe Woolen had two steam-powered mills in Utica, which manufactured worsteds and woolens. Maynard was Globe's principal shareholder and president. He was also a director and chairman of the executive committee of Utica Gas & Electric Co.\textsuperscript{19} Globe needed energy for several

\textsuperscript{16} \textsc{Ali, Principles of Corporate Governance}, § 4.01(c)(1) (Tent. Draft No. 4, 1985).
\textsuperscript{17} \textsc{Principles of Corporate Governance}, \textit{supra} note 1, § 1.18.
\textsuperscript{18} 224 N.Y. 483, 121 N.E. 378 (1918).
\textsuperscript{19} \textit{ld.} at 485, 121 N.E. at 378.
purposes, including operating and lighting its mills, heating the mills, and dyeing fabrics. Originally, the mills were operated and lit by steam that Globe generated in coal-fired steam boilers. Energy for heating and dyeing came from exhaust steam supplied by these boilers.\(^{20}\)

Greenidge, who then was superintendent and later was general manager of Utica G&E, suggested to Maynard that Globe substitute electric power for steam to operate its mills. Steam would still be needed, however, for heating and dyeing. Originally, nothing came of the suggestion, because Maynard was afraid that the cost of the necessary new equipment would be too great unless Utica G&E would guarantee a saving in the cost of operation.\(^{21}\) Eventually, however, Greenidge and Maynard made long-term contracts covering both mills. Under these contracts, Utica G&E agreed to supply Globe with electricity at a designated maximum rate, and guaranteed that Globe's cost of electricity for operating and lighting the mills, plus Globe's cost of coal for heating and dyeing, would be $300 less per month than Globe's prior cost of coal for operating and lighting the mills and heating and dyeing. After the contracts had been made, Maynard laid them before Utica G&E's executive committee, where they were adopted by a vote of disinterested directors.\(^{22}\)

The contracts turned out to be disastrous for Utica G&E. When the mills had been operated by steam, heating and dyeing involved little incremental cost, because Globe simply used excess steam from its steam-power generators. Now that the mills were operated by electricity, steam for heating and dyeing had to be generated by Globe as an independent coal-fueled operation, and producing the steam in this way was much more expensive than using by-product steam.\(^{23}\) Furthermore, Globe began dyeing more yarn in relation to slubbing (a kind of thread that is spun into yarn) than before. The dyeing of yarn took twice as much heat—again, coal heat—as the dyeing of slubbing, and thus doubled Utica G&E's fuel costs.\(^{24}\) These and like changes in the output of the mills had not been foreseen by Greenidge. The net result was that five years after the contracts had been made, Utica G&E had supplied Globe with electricity worth $60,000-$69,000, had been paid and was owed nothing, and itself owed Globe over $11,000 under the guarantee. If the contracts had run their full term, Utica G&E's loss would have been $300,000.\(^{25}\)

It's hard to believe that Maynard did not foresee the potential for disaster to Utica G&E. Perhaps Maynard had the undisclosed intention when he made the contract of increasing the amount of yarn Globe dyed, but that was not found as a fact. Even if Maynard did not have that undisclosed intention, however, he failed to provide Utica G&E with his expert counsel concerning the implications of the contract:

The trustee is free to stand aloof, while others act, if all is equitable and fair. He cannot rid himself of the duty to warn and to denounce,

\(^{20}\) Id. at 486, 121 N.E. at 378.
\(^{21}\) Id.
\(^{22}\) Id. at 487-88, 121 N.E. at 379.
\(^{23}\) Id. at 488, 121 N.E. at 379.
\(^{24}\) Id.
\(^{25}\) Id.
if there is improvidence or oppression, either apparent on the surface, or lurking beneath the surface, but visible to his practiced eye . . . .

It is no answer to say that this potency [of profit], if obvious to Maynard, ought also have been obvious to other members of the committee. They did not know, as he did, the likelihood or the significance of changes in the business. There was need, too, of reflection and analysis before the dangers stood revealed. For the man who framed the contracts there was opportunity to consider and judge. His fellow members, hearing them for the first time, and trustful of his loyalty, would have no thought of latent peril.

Unfairness of price was, therefore, evidence of unfairness of process, and although the contract had been approved by disinterested directors, the court held the contract could be rescinded.

In sum, approval by disinterested directors should not insulate a self-interested transaction from judicial review for fairness. Nevertheless, approval by disinterested directors is not without meaning. Although the rule of section 5.02 is that approval by disinterested directors should not eliminate review for fairness, two significant effects are accorded to such approval.

First, approval by disinterested directors shifts the burden of proof. Where a transaction has not been approved by disinterested directors, the burden of proof is on the self-interested director or senior executive to show that the transaction was fair. Where there has been approval by disinterested directors, the burden of proof is on the complainant.

Second, approval by disinterested directors changes the standard by which the self-interested transaction is measured. The complainant must show that disinterested directors "could not [have] reasonably . . . believed" the transaction to be fair to the corporation. This test is intended to be easier for the director or senior executive to satisfy than a pure fairness test, although harder to satisfy than the business-judgment standard.

To achieve these two effects, the approval of disinterested directors must be given in advance. Later ratification will not do. Partly, this is based on the desirability of encouraging directors and senior executives to seek advance board approval of self-interested transactions. (Indeed, it looks peculiar when a director or senior executive engages in a transaction with the corporation without first going to the board.) Perhaps more important, if approval is sought before a transaction is entered into, the disinterested directors have the opportunity to negotiate with the senior executive or director. In contrast, if the self-interested director or senior executive merely seeks ratification after the fact, as a practical matter the opportunity for negotiation will typically not be present. Finally, if the director or senior executive does not seek approval of his self-

26. Id. at 489, 121 N.E. at 380.
27. Id. at 491-92, 121 N.E. at 380.
28. Id. at 491-92, 121 N.E. at 380-81.
29. PRINCIPLES OF CORPORATE GOVERNANCE, supra note 1, § 5.02(b).
30. Id. Comment to § 5.02, at 27.
31. Id. § 5.02(a)(2)(B).
interested transaction until it has been consummated, his colleagues are put on
the spot. The question then before the board is not whether a proposed transaction
is advantageous to the corporation, but whether a consummated transaction is
so disadvantageous that a colleague should be exposed to a lawsuit.

Suppose now that a self-interested transaction has been approved by dis-
interested shareholders. Under section 5.02, the transaction is subject to review
only under the waste test. Waste is defined under section 1.34 to mean "a
transaction . . . [whose] terms are such that no person of ordinary sound
business judgment would say that the consideration received by the corporation
was a fair exchange for what was given by the corporation." It can be argued
with considerable force that even transactions approved by disinterested share-
holders should be subject to a fairness test, because it is difficult to ensure that
shareholders reading a proxy statement will thoroughly understand the issues
involved in such cases. The rule limiting review to a waste test is based partly
on the ground that the shareholders are, after all, the owners of the corporation,
and partly on the utility of providing at least one safe harbor for self-interested
transactions. Unlike approval by disinterested directors, later ratification by
disinterested shareholders should be as effective as prior authorization. Disin-
terested shareholders, unlike disinterested directors, are not in a collegial rela-
tionship with the interested directors, and would have no reason to be concerned
about exposing a director or senior executive to suit.

Finally, special treatment is given to self-interested transactions involving
compensation. Compensation differs from other self-interested transactions in
two important respects. First, because compensation depends heavily on the
individual characteristics of each manager, it is extremely hard to find market
equivalents by which to measure fairness. Second, unlike other self-interested
transactions, compensation transactions with insiders are a matter of necessity.
Most self-interested transactions can be avoided by contracting on the market
with third parties; compensation transactions cannot. Section 5.03 of the PRIN-
ciples of Corporate Governance, following the case law, therefore breaks
off compensation transactions for separate treatment by adopting the rule that
if full disclosure has been made, and the compensation has been approved by
disinterested directors, it will be reviewed only under a business judgment stan-
dard. In the absence of disinterested director approval, however, compensation
should be treated like other self-interested transactions.

The principle underlying the framing of Restatements is that a rule of a
Restatement should state the rules that the courts would follow, giving weight
to all the considerations that the courts would deem it right to weigh. Section
5.02 of the Principles of Corporate Governance reflects that principle. The
moral norms, policies, and experiential propositions that underlie the rules of
that section are just those norms, policies, and experiential propositions that

32. Id. § 5.02(a)(2)(C).
33. Id. § 1.34. This definition follows Michelson v. Duncan, 407 A.2d 211 (Del. 1979).
35. Principles of Corporate Governance, supra note 1, § 5.03(a)(2)(B).
36. Id. § 5.03(a)(2)(A).
courts should take into account in establishing the rules that govern self-interested transactions. The rules of section 5.02 are also well supported by the authorities. The conjunctive test of fairness and full disclosure, for example, is supported not only by corporate-law precedents, but by the law of contracts, agency, restitution, and trusts.

In many states, self-interested transactions are affected by statutes. Section 14A:6-8 of the New Jersey statute is typical. It provides:

(1) No contract or other transaction between a corporation and one or more of its directors . . . shall be void or voidable solely by reason of such . . . interest . . . if

(a) the contract or other transaction is fair and reasonable as to the corporation at the time it is authorized, approved, or ratified; or

(b) the fact of the common directorship or interest is disclosed or known to the board or committee and the board or committee authorizes, approves, or ratifies the contract or transaction by unanimous written consent, provided at least one director so consenting is disinterested, or by affirmative vote of a majority of the disinterested directors, even though the disinterested directors be less than a quorum . . . .

It is unclear whether, under such a statute, the court can review for fairness a self-interested transaction that has been approved by disinterested directors. Subsections (a) and (b) provide that a transaction is not void or voidable solely because of its self-interested nature if either disinterested directors authorize the transaction or the transaction is fair and reasonable. This disjunctive formulation seems to suggest that if a self-interested transaction is authorized by disinterested directors, fairness is irrelevant. However, these subsections are folded within an overall provision that states that no transaction shall be void or voidable “solely” because of its self-interested nature. Recall that under the original common-law rule, self-interested transactions were automatically voidable without regard to fairness. The statute can therefore be interpreted to be aimed only at reversing that rule, not at eliminating a fairness test. In Scott v. Multi-Amp Corp., the court so held:

The parties disagree over whether the aforesaid statutory revision operates to relieve a director of the burden of proving the fairness of contracts between his corporation and himself. Manifestly it does not. This court . . . perceives nothing in the revised enactment to suggest that the legislature intended it to alter the traditional doctrine that a fiduciary who engages in self-dealing must endure the burden of proving that a challenged transaction is fair and equitable.

38. See, e.g., Talbot v. James, 259 S.C. 73, 82-84, 190 S.E.2d 759, 764-65 (1972).
39. See Restatement (Second) of Agency § 390 (1957); Restatement (Second) of Contracts § 161 (1979); Restatement of Restitution § 191 (1936); Restatement (Second) of Trusts § 170 (1957).
42. Id. at 67-68.
Other courts have arrived at comparable conclusions under comparable statutes, but the position of the Delaware court is unclear. In *Fliegler v. Lawrence*, a shareholder in Agau Mines, Inc. brought a derivative action attacking a self-interested transaction that had been ratified by Agau’s shareholders. The court said:

Defendants argue that the transaction here in question is protected by §144(a)(2) which, they contend, does not require that ratifying shareholders be “disinterested” or “independent”; nor, they argue, is there warrant for reading such a requirement into the statute . . . . We do not read the statute as providing the broad immunity for which defendants contend. It merely removes an “interested director” cloud when its terms are met and provides against invalidation of an agreement “solely” because such a director or officer is involved. Nothing in the statute sanctions unfairness to Agau or removes the transaction from judicial scrutiny.

In *Marciano v. Nakash*, the court upheld as fair a self-interested transaction that had not been approved by either disinterested directors or disinterested shareholders. In the text of its opinion, the court seemed to reiterate *Fliegler*:

*Fliegler*, a post-section 144 decision, refused to view section 144 as either completely preemptive of the common law duty of director fidelity or as constituting a grant of broad immunity. As we stated in *Fliegler*: “It merely removes an ‘interested director’ cloud when its terms are met and provides against invalidation of an agreement ‘solely’ because such a director or officer is involved.” . . . In *Fliegler* this Court applied a two-tiered analysis; application of section 144 coupled with an intrinsic fairness test.

However, a footnote to the opinion seems to look the other way:

Although in this case none of the curative steps afforded under section 144(a) were available because of the director-shareholder deadlock, a non-disclosing director seeking to remove the cloud of interestedness would appear to have the same burden under section 144(a)(3), as under prior case law, of proving the intrinsic fairness of a questioned transaction which had been approved or ratified by the directors or shareholders . . . . On the other hand, approval by fully informed disinterested directors under section 144(a)(1), or disinterested stockholders under section 144(a)(2), permits invocation of the business

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44. 361 A.2d 218 (Del. 1976).

45. Id. at 222.

46. 535 A.2d 400 (Del. 1987).

47. Id. at 404.
judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction.\textsuperscript{48}

Some of the statutes explicitly provide that the board must act in good faith, and such a requirement is implicit even where not explicit. It is hard to conceive of a case in which a "disinterested" director could, in good faith, approve a self-interested transaction by a colleague that could not reasonably be believed to be fair to the corporation. A contrary rule would be so perverse that in the absence of the most explicit language by the legislature, the courts should not interpret the statutes to reach such a result. If the statutes are properly interpreted, therefore, the rules stated in section 5.02 are consistent with the statutory formulations as well as the common law.

\textsuperscript{48} \textit{Id.} at 405 n.30.