

it has no choice. This follows from the fact that it cannot rely on the business judgment of the board. By definition the board cannot exercise its judgment objectively, for its actions depend on the vote or votes of interested directors. *Shlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E.2d 793 (1960); *Gottlieb v. Heyden Chem. Corp.*, 33 Del. Ch. 82, 88, 90 A.2d 660, 663 (Sup.Ct. 1952).

The understandable reluctance of courts to directly judge the reasonableness of a corporate transaction except where there is no other alternative is expressed in many decisions. The principle appears in the familiar *American Tobacco* case of *Rogers v. Hill*, 60 F.2d 109 (2d Cir. 1932), *rev'd*, 289 U.S. 582 (1933), where the compensation of six executives was attacked. Judge Swan, whose dissenting position in the Court of Appeals was later upheld by the Supreme Court, stated the principle as follows:

"The determination of fair compensation for services is primarily for the directors. Courts hesitate to overrule the discretion of directors fairly exercised." (60 F.2d at 114)

Another leading case expressing this reluctance is *Seitz v. Union Brass & Metal Mfg. Co.*, 152 Minn. 460, 189 N.W. 586 (1922), where the court found in favor of the defendants who were charged with receiving excessive salaries.

"In determining whether salaries are excessive and unreasonable so that there should be a restoration courts proceed with some caution. An intolerable condition might result if the courts should too lightly undertake the fixing of salaries at the suit of dissatisfied stockholders. An issue as to the reasonable value of the services of officers is easily made. It is not intended that courts shall be called upon to make a yearly audit and adjust salaries. The dissenting stockholder should come into court with proof of wrongdoing or oppression and should have more than a claim based on mere differences of opinion upon the question whether equal services could have been procured for somewhat less." (152 Minn. at 464-65, 189 N.W. at 587-88)

Particularly appropriate is the statement of the court in *Cullen v. Governor Clinton Co.*, 279 App. Div. 483, 485, 110 N.Y.S.2d 614, 616 (1952), where a dissident stockholder attacked a management contract between a corporation owning a hotel and a hotel management company.

"Whether the hotel could better be operated through the medium of a management company presented a question of business judgment. If the decision had been arrived at as the result of an honest, prudent and careful belief of the directors that it was for the best interest of the hotel company, then that determination would not be subject to interference by the courts, even though an error in judgment may have been committed." (279 App. Div. at 485, 110 N.Y.S.2d at 616)

2. APPROVAL BY INDEPENDENT DIRECTORS

A different situation obtains when there is a disinterested majority of directors able to consider the transaction. Here the courts recognize the basic representational structure of corporate form. That is, within limits of proper conduct, it is the duty and function of a board of directors to exercise their business judgment in determining whether a transaction is in the interest of the corporation. If a majority of the directors are not interested in the transaction and are free of domination by the interested director, then there is no reason to suspect or ignore their judgment unless on its face the terms of the transaction are so unfavorable to the corporation that it is beyond the board's power to approve it. Courts have used a variety of expressions, including "waste" and "gift of corporate property", to describe such unfavorable transactions. Regardless of the words used, the principle is the same—i.e., the court will upset the decision of the board only where it concludes that the board's judgment is manifestly out of line with what a reasonable man's business judgment could be. See *Beard v. Elster*, 39 Del. Ch. 153, 162, 160 A.2d 731, 737 (Sup. Ct. 1960). When such a transaction is challenged not only is the above standard applied, but the complaining party has the burden of showing that the arrangement was so extreme that it should be rescinded. This approach is partly a result of courts being reluctant to interfere in the judgment of an independent board whose very function is to make this kind of decision. It also reflects the desirability of maintaining stability and certainty in affairs of corporations and their contracts with others. If, when challenged by a stockholder (or the SEC), independent boards of corporations generally were required to show the fairness of every contract