**CONFLICTS OF INTEREST IN CORPORATE TRANSACTIONS**

**1.DUTY OF LOYALTY**--because of their fiduciary relationship with the corp, officers and dirs have the duty to promote the interests of the corp without regard for personal gain.

**2.BUSINESS DEALINGS WITH THE CORPORATION**--conflict of interest issues arise when a corp transacts business with one of its officers or dirs, or with a company in which an officer or dir is financially interested.

**a)Effect of Self-Interest on Right to Participate in Meeting**--most statutes permit an “interested” dir to be counted toward quorum, and interested dir’s transactions are NOT automatically voidable by the corp because the interested dir’s vote was necessary for approval.

**b)Voidability Because of Director’s Self-Interest**--today, such transactions are voidable only if **unfair** to the corporation. The burden of establishing fairness is on the interested director. Note that a dir’s failure to **fully disclose** material facts may be per se unfair.

1)Unanimous shareholder ratification--if, after **full disclosure**, shareholder ratification is unanimous, the corp will be estopped from challenging the transaction with the interested dir (except at to creditors).

I)Less-than-unanimous ratification--courts then will look at whether the majority shares were owned or controlled by the interested director. Courts are more likely to uphold ratification by a disinterested majority so as to preclude the transaction from being attacked by the corp or by a sh in a derivative suit.

2)Statutes--most statutes provide that such transactions are NOT voidable if: (1)approved, after full disclosure, by a disinterested board majority or by majority of shs, or (2)the transaction is **fair** to the corp notwithstanding disclosure.

I)”Interested”--an “interested” dir or officer is one who has a business, financial, or familial relationship with a party to the transaction that would reasonably affect the person’s judgment so as to adversely affect the corp.

**c)Remedies**--the corp may rescind, or affirm and sue for damages.

**3.INTERLOCKING DIRECTORATES**--generally, transactions between corps with common dirs are subject to the same rules of interested director transactions. There is no conflict of interest if one corp is the wholly owned subsidiary of the other. However, a question of fairness arises where the parent owns only a majority of the subsidiary’s shares.

**4.CORPORATE OPPORTUNITY DOCTRINE** (Also see duty of loyalty)

**a)Definition**--COD bars dirs from taking any business opportunity belonging to the corp without first offering it to the corp.. If the corp is **unwilling** to pursue an opportunity (after an independent board is fully informed of the opportunity), then the dir may pursue it.

**b)Defenses** (available in most, but not all jurisdictions):

1)Inability--If the corp is legally or financially **unable** to take the opportunity, then the dir generally may take advantage of it. (But the question of who caused the financial inability is quite relevant. Example: Irving Trust Co--the defense of inability was rejected).

2)Rejection, abandonment, or approval--then the fiduciary has a valid defense.

**c)Remedies**--constructive trust or damages--the fiduciary must account to the firm for all the profits he has made as a result of usurpation.

**d)Definition of a Corporate Opportunity**:

1)Line of business test--does the firm have fundamental knowledge, practical experience, and ability to pursue the opportunity? If yes, then it is within the firm’s line of business. It should be a natural fit, and not a mere desire by a firm to pursue the opportunity.

2)Interest/expectancy test

**e)Application--Guth Rule and Corollary**:

1)Guth rule (offered in **corporate capacity**)--if there is presented to O/D a business opportunity which the corp is (1)financially able to undertake, which is from its nature (2a) in the line of business and is of practical advantage to it OR (2b)is one in which the corp has an interest or reasonable expectancy (under an established corporate policy or plan), and, (3)by embracing the opportunity the self-interest of the dir will be brought into conflict with that of his corp, then officer or dir may NOT take the opportunity.

2)Guth corollary (a safe harbor; satisfy all provisions and dir can take)--if a business opportunity (1)comes to O/D in his **individual capacity** and (2) is not essential to the corp and is (3)one in which corp has no interest or expectancy, then the O/D can treat it as his own, IF he has not taken corporate resources to pursue the opportunity.

I)”Essential”--indispensably necessary to the continued viability of the firm;

ii)Individual or corporate? Look at O/D capacity to determine how offer was made

**5.COMPETING WITH CORPORATION**--such competition by a dir or officer may be a breach of fiduciary duty even when the competing business is **not** a corporate opportunity

**6.COMPENSATION FOR SERVICES TO THE CORPORATION**--the compensation plan must be duly authorized by the board, and its terms must be reasonable. Good faith and the BJR ordinarily protect disinterested dirs from liability to the corp for approving compensation.

**a)Publicly Held Corporations**--The SEC has authorized shs to make proposals about executive pay in management’s proxy statements. Further, the tax code now limits expense deductions for executive pay over $1mln, unless it is tied to the corp’s performance.

**b)Past and Future Services**--compensation for **past services** is generally invalid. Compensation for **future services** is proper if there is reasonable assurance that the corp will receive the benefit of the services.