Controlling the Controllers in Parent-Subsidiary Relations

James C. Bruno
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James C. Bruno*

I. Introduction

This article will examine the rights and responsibilities of a party in control of a corporation. The discussion of these rights and responsibilities focuses principally on the law of Michigan. However, passages on policy, discussion of the development of relevant Michigan law, and recommendations for changes in the law are pertinent to the general problem-area of parent-subsidiary relations encountered in all jurisdictions.

The terms "parent" and "subsidiary" are used in this article because of their familiarity, although terms such as "dominating shareholder" and "controlling entity" are often substituted for "parent." The term "relation," as used in this article, includes any contract, gentlemen’s agreement, directive, exercise of influence, or any other interaction between a corporation and another party. This article will investigate the law regulating direct parent-subsidiary relations which involve injury to the subsidiary. Topics such as the purchase of shares from shareholders, many forms of oppression of minority shareholders (e.g., refusal to declare dividends), sale of control, and competition with the corporation are not, however, within the scope of this article. In such cases, the primary injury is not to the corporation, and its parent is not involved.  

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2A recent New York Court of Appeals decision has held that the corporation may recover insider trading profits although the individual shareholders and not the corporation were the injured parties. Diamond v. Oreamuno, 37 L.W. 2691 (1969).
II. Sources of Michigan Law Governing the Parent-Subsidiary Relation

The common-law was the original regulator of the parent-subsidiary relationship both in Michigan and elsewhere.\textsuperscript{3} In the last half of the nineteenth century, the Michigan Supreme Court extensively considered the problem of corporate officers, directors, and agents dealing with their corporation or acting simultaneously for different corporations. The court's early decisions were not in agreement as to which branch of the common law governed the relations. These early decisions applied the law of agency, trusts and contracts in the court's search for the appropriate body of law. The fiduciary cases of the 1800's, which centered on an agent's duty to his employer, generally did not involve corporations and their control parties. These cases, however, gave rise to many doctrines which are part of the present common-law governing dealings between parents and their subsidiaries. These doctrines are examined in parts III, IV and V.

By the early 1900's, the Michigan courts had settled upon the law of trusts to restrict parent corporations and other control parties.\textsuperscript{4} While the courts utilized trust law principles in deciding parent-subsidiary cases, they did not attempt to apply the entire law of trusts to such relationships.

The language in the decisions, however, fails to make this limited application explicit. This failure leaves much leeway for the imposition of duties upon control parties that may retard commercial and economic growth.\textsuperscript{5} A control party is not a

\textsuperscript{3}In general see Latty, Subsidiaries and Affiliated Corporations (1936).


\textsuperscript{5}An excessive amount of contingent liability may dissuade talented businessmen from accepting corporate positions. See Loomis, \textit{A Squeeze on Directors}, \textit{FORTUNE}, May 15, 1969, at 146. An example of a trust doctrine which, if adopted to regulate fiduciary relations, would impose excessive contingent liability is in Mosser v. Darrow, 341 U.S. 267, 95 L. Ed. 927, 71 S. Ct. 680 (1951). The Court held the trustee in bankruptcy liable for the concealed profits of his employees although the trustee personally had no gain from the transaction. One commentator on the Mosser case wrote:

Moreover, since Supreme Court decisions in bankruptcy are liberally cited in cases involving common trustees and equity receivers, there is little doubt that the decision will apply to them as well. 52 \textit{COLUM. L. REV.} 514,521 (1952).
"trustee" in the fullest sense of the word. For example, a new "trustee" will not be appointed by the court if the party surrenders his control, a control party does not have legal title to the corporation's property, and a "trustee" is not subject to judicial supervision of his management of the corporation.

A less confusing approach would be to consistently characterize a control party as a "fiduciary" or "corporate fiduciary." Under such an approach, the parent would be governed by the general duties of a fiduciary or perhaps by special rules of the common law of corporate fiduciaries to be developed by the judiciary or the legislature. Indeed, the term "fiduciary" may itself be overly broad. The workings of intercorporate relations continue to evolve, and the law regulating them need not be inflexibly bound by the old duties of a trustee or of a fiduciary. Reforms stated in the language of existing principles may, however, present a greater likelihood of acceptance.

The Michigan Legislature has intervened to regulate particular aspects of the parent-subsidiary relationship, although no section of the Michigan General Corporation Act (M.G.C.A.)\(^6\) establishes

\[^6\] MICH. COMP. LAWS §§ 450.1-.193 (1967). Compare PA. STAT. tit. 15, § 408 (1967), officers and directors stand in a "fiduciary relation to the corporation." In at least one case the Michigan Supreme Court has impliedly held that the common law duty of a fiduciary has been enacted into § 450.47 of MICH. COMP. LAWS (1967) which reads in part:

> The directors of every corporation, and each of them, in the management of the business, affairs, and property of the corporation, and in the selection, supervision and control of its committees and of the officers and agents of the corporation, shall give the attention and exercise the vigilance, diligence, care and skill, that prudent men use in like or similar circumstances.

a general rule to govern a parent’s dealings with its subsidiary. One unanswered question of Michigan corporate common law continues to be whether the M.G.C.A. statutory provisions supplement or supplant the common law. The question is examined infra.

Parent-subsidiary relations in Michigan are also affected by statutes other than the M.G.C.A. These statutes include state and federal antitrust and securities laws; they are sufficiently different in rationale and sufficiently complex to merit independent consideration.

III. The Concept of Control and its Relation to the Duty of a Parent.

A. The Requirement that Control Exist.

Under Michigan law, a director, as well as a party which dominates such a director, owes the duty of a fiduciary to the corporation, shareholders, and creditors. This fiduciary duty exists whether or not control of the corporation is present. Although the Michigan decisions do not directly so hold, implicit in at least their early reasoning is the rule that the existence of corporate control raises the fiduciary duty of directors and others to a higher duty such as the duty of a trustee. This distinction between a non-controlling fiduciary and a controlling trustee implies that the duties owed by each to the corporation are different. In fact, these duties are not different and thus, the doctrine of control gives rise to a distinction without a difference.

7See Kaplan, Shareholder Attacks on Mergers and Acquisitions Under Federal Securities Laws, 50 Chi. B. Rec. 441, 445 (1969). See also Schoenbaum v. Firstbrook, 405 F.2d 200 (2nd Cir. 1968), where the court allowed a 10b-5 action against dominating shareholders who purchased shares at an allegedly inadequate price.


10The Michigan decisions have settled the principle that the duty of a fiduciary is not imposed upon a majority stockholder until control exists. Fenestra v. Gulf Land Development Co., 377 Mich. 565, 141 N.W.2d 36 (1966).

11See note 6, supra.

12Accord, Callaghan's Mich. Civ. Jur. Corporations § 79 (Directors as fiduciaries) and § 166 (Control by majority; rights of minority). According to the strict language of the
The law regulating a fiduciary’s duty to the corporation is capable of protecting a corporation, stockholders, creditors, and other interested parties such as employees and suppliers. In addition, its applicability is not contingent upon the existence of control. It is the author’s view that no worthwhile reason exists for continuing the doctrine of control and for the consequent application of the law of trusts to regulate the parent-subsidiary control relationships. The duty of a director not part of a control group should be the same as the duty of those directors in control of the corporation. Accordingly, the status of control party should not give rise to any special categorization such as that of a trustee. All fiduciaries should bear the same obligations and duties, whether or not they are in a control position.

The author’s argument aside, Michigan decisions appear to attribute some importance to the existence of control. The court will diligently make a determination as to the existence of control; yet the rules it applies to a party in control are indistinguishable from the rules it applies to a non-controlling fiduciary. The author has found no Michigan decision which holds a control-entity trustee to a stricter standard than a non-control entity fiduciary. Thus, there is no practical reason for continuing the doctrine of control.

Michigan decisions, the possession of control makes the controller a fiduciary. Fenestra v. Gulf America Land Corp., 377 Mich. 565, 141 N.W.2d 36 (1966), or trustee, Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892), vis-a-vis the minority shareholders. The obligations of such a trustee or fiduciary are enforced by the corporation directly or through a derivative action with any recovery inuring to the benefit of the corporation. Where the acts of a non-controlling director are challenged, the courts hold that the director is a fiduciary of the corporation itself. A violation of this duty may also be enforced by the corporation directly or through a derivative action with any damages recovered paid to the corporation. Kimball v. Bangs, 321 Mich. 394, 32 N.W.2d 831 (1948). Michigan law provides for the recovery by shareholders who are damaged beyond the amount of loss to the company by the acts of a control party. Wagner Electric Corp. v. Hydraulic Brake Co., 269 Mich. 560, 257 N.W. 844 (1934). There would be no need to limit this liability to shareholders and others to instances when the offending fiduciary was also a control party, cf. Mich. Comp. Laws § 450.47 (1967).

13For example, rules governing the sale of control by a majority of the board of directors should also apply to a minority of the board.

14It would appear that the Michigan Legislature is in agreement with the author and not with the judiciary, as the sections of the M.G.C.A. dealing with parent-subsidiary corporation contracts do not give weight to the existence or non-existence of control. e.g. §§ 13(5), Mich. Comp. Laws 450.46 (1967).
B. Concept of Control

A justification for eliminating the concept of control from the law governing parents and subsidiaries lies in the inherent difficulty in determining its existence and its possessor.

1. Existence of Control

One problem is establishing the proper time period to examine in determining whether control exists. Its existence may be a matter of days or hours and may encompass only one board meeting. Thus, it will be quite difficult to pinpoint exactly when control does exist. In the author's opinion, the relevant time period for determining whether control exists is the day or days during which the challenged relation existed.\(^\text{15}\)

The problems of determining the nature of the relation and its time period will exist even if the court does not use the doctrine of control since the existence of a fiduciary relationship is a necessary prerequisite to conclusion of liability. However, this determination of fiduciary status is more easily made than ascertaining the existence of control. Where the alleged control party is not a single person or entity who openly controls the corporation, the proof of the existence of control will often depend upon unknown agreements and parallel voting patterns among the directors.\(^\text{16}\)

2. Possession of Control

A person or group need not own or control over fifty percent of

\[^{15}\text{See Note, Corporate Fiduciary Doctrine in the Context of Parent-Subsidiary Relations, 74 Yale L.J. 338, 350 (1964).}\]

\[^{16}\text{An interesting problem is presented when deciding whether a majority vote by the board of directors is simply an ad hoc majority rather than a control group. The practical resolution of this question requires delving into events prior to the action of the board to which objection has been made. Historical voting patterns, proof of collusive agreements, contemporaneous statements and other evidence that the majority was acting as a group may be introduced. This conjuring of the control devil, where no definite agreement by the group exists, is too great a threat to the doctrine of majority rule to be worthwhile as it may subject the majority to "trustee" liability on every vote. Merely saying, however, that proof of a definite agreement to act as the group should be required before burdening the majority with the duties of a trustee leaves much to be said. For example, the Michigan court has not had to decide what the appropriate standard of proof should be.}\]
a corporation's voting stock to be in control. The amount of stock ownership is generally irrelevant to the question of whether control exists. The Michigan rule appears to be that control exists when a group of directors or shareholders, by their own agreement or under the direction of another, act together to manage the corporation and possess sufficient power to do so.

The ownership of fifty-one percent of the stock or voting rights does not make the owner a control party under Michigan law. The potential for control exists, but this potential is not sufficient to impose control status. If such a person voted for directors independent of his control, did not attempt to influence their votes, and did not make their re-election to the board dependent upon following his instruction, he would not be a control person under Michigan law. In fact, a person with a recently acquired majority ownership who intends to manage the corporation, but who has not yet been elected to, nor had his agents placed on, the board of directors, is not yet a control party. Furthermore, it appears that if no prior voting trust or similar agreement had been concluded, and no one stockholder controlled a majority of the directors, no controlling-controlled relationship existed, but only a majority-minority result in the voting.

The present legal importance of the existence of control and the difficulty of defining control is unfortunate. Protection of the corporation, as well as those with an interest in it, can be adequately achieved by relying upon the fiduciary duty owed by all directors. This distinction between those in control and those out

20The question is raised whether a president who operates the company with a free hand is transformed into a control person, or whether the Mich. Comp. Laws prevents this by giving the right, power and duty of management to the board. A second question raised is whether a board chairman who dominates the board because of his presence, reputation, ability, and power of persuasion is a control person. These questions remain unanswered in Michigan and add to the confusion surrounding the doctrine of control.
21To impose a trustee status on a director, merely because he voted with the majority would be to impose a penalty without a reason for it. Of course the author maintains that the present Michigan law on corporate trustees is no different than the Michigan law on corporate fiduciaries.
of control merely complicates the process by which courts seek to protect the corporation and interested parties.

IV. The General Right of a Parent to Control the Operation of a Subsidiary Corporation

The general right in Michigan of one corporation to direct the affairs of another corporation depends upon the method used to acquire control. Formation of a control group by simple contract is restricted. In *Scripps v. Sweeney*, the Michigan Supreme Court held void a contract between four of the nine director-shareholders of four newspapers. Each paper was a separate company, but the same shareholders held varying percentages of stock in each newspaper. The four contracting shareholders together held a majority of the shares in the four papers. They agreed that each newspaper would work in concert with the others, that the interests of the combination would be superior to the interests of each individual paper, and that each paper would be entitled to the journalistic and business secrets of the others. At the same time, the newspapers were to remain independent in journalistic and business policy. The court held that the agreement violated public policy as it bound them to carry out the agreement "... whether or not for the best interests of the corporations, respectively, ..." The court did state that the agreement would have been valid if all of the shareholders had agreed to it.

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22160 Mich. 148, 125 N.W. 72 (1910).
23Id. at 164, 125 N.W. at 76. The decision could be read to prevent only those management contracts in which there is personal aggrandizement.
24Id. at 164, 125 N.W. 79. The Michigan court has also ruled void as against public policy a loan contract vesting in the lender "... complete charge of finances" for the duration of the loan, *Marvin v. Solventol Chemical Products*, 298 Mich. 296, 298 N.W. 782 (1941). The contract was unenforceable despite the fact that it bore the signature of the corporation rather than of the directors. The directors could not avoid their duty to manage by having the corporation agree to such abdication. This holding raises questions as to the validity in Michigan of clauses in bonds and preferred stock turning over control of the board to the creditors in case of default. *See Ringling Brothers-Barnum & Bailey Combined Shows v. Ringling*, 29 Del. Ch. 610, 53 A.2d 441 (1947) (dicta upholding such clauses); *Eccleston v. Indialantic, Inc.*, 319 Mich. 248, 255, 29 N.W.2d 679, 681 (1947) (upholds stockholder-creditor keeping voting rights when selling shares). Most U.S. jurisdictions, including Mich-
Although control may not be acquired by simple contract with the corporation or its directors, valid methods are available. Under Michigan law, all of the shareholders may join together to vest control of the corporation in a group of persons. This control arrangement may be accomplished by an agreement to vote in a particular manner for the board of directors. All of the shareholders may also agree to vote in a particular manner on proposals presented to them.

The acquisition of control by agreement of less than all of the shareholders is restricted. In 1932, the Michigan Supreme Court approved the doctrine that a stockholder could not separate the voting power from his shares by means of an agreement to vote in a particular manner, or through appointment of a proxy, if such separation was done for a personal profit. The court failed to provide any definition or examples of what constitutes a profit except to rule that a cash payment was profit. However, any minority or majority could reach an accord on a particular course of action if none received a personal gain except for the promise of others to vote in a certain manner. Thus, the independence of a shareholder's vote could be compromised only where no personal profit was involved.

Without acknowledging the "personal profit" doctrine or the case which gave rise to it, Michigan was presented in 1947 with a new rule in Ecclestone v. Indialantic, Inc. The court held that split of the legal ownership from the exercise of the voting rights would be enforced if there was some benefit to the corporation or some corporate purpose was served, although the person who separated the ownership rights may also have received some "personal interest." The case containing this pronouncement was unusual in that the stock and legal ownership were transferred,

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but the voting rights were retained.\textsuperscript{29} The usual transaction is a retention of stock ownership with a splitting off of the voting rights. The seller retaining his voting rights was a creditor, director and corporate attorney, and he was to continue his services after the sale.

The author does not object to the results or to the substantive rules of law as stated in the \textit{Ecclestone} decision. The unfortunate aspect of the decision is the failure of the court to distinguish or even consider contemporary Michigan precedent prohibiting a separation of voting rights for a personal profit, which was applicable and perhaps conflicting.\textsuperscript{30} The rule would appear to be that a separation of stock ownership from the exercise of voting rights is proper in Michigan if a corporate purpose exists even though a personal "interest" is served, whereas such a separation is improper if a personal "profit" is made.\textsuperscript{31} The legality of such transactions in which a corporate purpose is served and a personal "profit" is made is unclear. It is possible that the distinction between "profit" and "interest" is one of flagrancy.

To acquire control and yet to avoid the problem of the illegality of simple contracts for control, and to avoid the uncertainty of the legality of shareholder voting agreements\textsuperscript{32} in which personal gain results, recourse may be had to a statutory voting trust; to the purchase of voting shares; or to the use of proxies without paying a consideration.\textsuperscript{33}

\textsuperscript{29}This fact was not discussed by the court. The case was treated as though the present owner had given a proxy to his transferor. This is something he could not have done as he never possessed the right to vote the shares under the terms of the transfer.

\textsuperscript{30}The possible conflict was with Stott v. Stott, 258 Mich. 547, 242 N.W. 747 (1932) which held a separation of stock ownership from the exercise of voting rights invalid if a personal profit was realized.

\textsuperscript{31}Illegal purpose, fraud, violation of antitrust law, and breach of fiduciary duty are among the other available challenges to a shareholder's agreement.


A corporation legally in control of another has the right, under Michigan law, to manage the latter without interference from the minority. This authority is limited by the parent corporation’s common law duty as a trustee or fiduciary and by certain statutory provisions. These restrictions are discussed below.

**V. Restrictions on a Parent’s General Right to Manage and Direct a Subsidiary.**

The pervasive restriction imposed upon a controlling party is that the controlling person, including a parent corporation, must manage the subsidiary for the benefit of all, including the subsidiary corporation, its shareholders, and its creditors. This duty arises from the control person’s status as a trustee or fiduciary.

Persons occupying this relation towards each other are under an obligation to make the property or fund productive of the most that can be obtained from it for all who are interested in it; and those who seek to make a profit out of it, at the expense of those whose rights in it are the same as their own, are unfaithful to the relation they have assumed and are guilty, at least, of constructive fraud.

The problem is to translate this generalized statement of obligation into rules covering specific relations between the parent and its subsidiary. Subsidiaries are not illegal, and the law should not subject a parent to potential liability on every relation with its subsidiary based upon a subjective standard such as the one quoted above.

The common law in Michigan has developed around the requirements that parent-subsidiary relations are void or voidable unless:

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34 One Michigan decision has held the only duty of the majority is not to commit fraud. Crowe v. Consolidated Limber Co., 239 Mich. 300, 214 N.W. 126 (1927). This does not give sufficient protection to the corporation and to those with interests in it as fraud requires a misrepresentation and not merely a violation of duty. This is not good law today.


A) the terms of the relation are fair to the subsidiary; and
B) the relation is completely disclosed; and
C) the relation is ratified.

The legislature has incorporated one or more of those doctrines in its statutory regulation of certain common intercorporate relations.\(^{37}\)

\textit{A. The Doctrine of Fairness}

1. Establishment of the Doctrine

Early Michigan cases hold that contracts made by an interested fiduciary were void, not merely voidable.\(^{38}\) Good faith or honesty would not save the contract under these early decisions: “The fairness or unfairness of the transaction is not open to proof or discussion.”\(^{39}\)

The first Michigan decision involving a claim of injury caused by a control group’s manipulation of the corporation was \textit{Miner v. Belle Isle Ice Co.}\(^{40}\) One alleged fraudulent act was the rental of property owned by the dominant member of the control group to the corporation at an inflated price. After citing the Michigan rule that such contracts were void, the Supreme Court added,

\begin{quote}
In any case the burden is upon the director to show fairness, reasonableness, and good faith, and upon this record these transactions must not only be held to be constructively fraudulent, but fraudulent in fact.\(^{41}\)
\end{quote}

The court was stating that even if they would adopt the rule that

\(^{37}\)The statutory uses of the three doctrines are described in their respective subsections, infra.


\(^{39}\)Dwight & Pierce v. Blackmar, 2 Mich. 330,335 (1852). This rule was identical to the English rule and it had been adopted by many other American jurisdictions. Bowman, \textit{The Validity of Contracts Between Corporations Having Common Directors}, 4 Mich. L. Rev. 577 (1904).

\(^{40}\)93 Mich. 97, 53 N.W. 218 (1892). \textit{See also} Wilbur v. Stoeppl, 82 Mich. 344, 46 N.W. 724 (1890).

\(^{41}\)Miner v. Belle Isle Ice Co., 93 Mich. 97, 111-12, 53 N.W. 218, 222-23 (1892).
such contracts are voidable subject to proof of their fairness, reasonableness, and good faith, these three standards were not met by the defendant control party.

The Michigan Supreme Court discarded its rule which voided transactions by an interested fiduciary in Aldine Mfg. Co. v. Phillips.\textsuperscript{42} The court stated the rule that "When the transactions are open, honest, and fair and known to the officials of both companies, they will be sustained."\textsuperscript{43} The court held in Aldine that the question of fairness is to be one of fact. A charge that the corporation paid more than it would have paid if purchasing from a firm in which the fiduciary was not interested was successfully met by proving both the superior quality of the items actually purchased and the making of only a "reasonable" profit on them. Thus the doctrine of fairness became part of Michigan common law.

Today the doctrine of fairness pervades the law governing parent-subsidiary relations in Michigan and other U.S. jurisdictions,\textsuperscript{44} except perhaps in the sale or lease of substantially all of the subsidiary's assets, or in a merger or a consolidation where actual fraud by the parent must be proven.\textsuperscript{45}

\textbf{2. Burden of Proving Fairness.}

The challenged fiduciary bears the burden of proving fairness.\textsuperscript{46} One Michigan decision holds that the burden of proving fairness may be more easily satisfied if the transaction is at arm's length.\textsuperscript{47} The court's homilies on arm's length transactions are unrealistic when applied to situations involving parents or any powerful fiduciary. The discussions of arm's length transactions ignore the inequality of bargaining positions in such relations, and the stan-
standard itself is impossible to apply in those instances where two completely independent parties would not or could not be involved, such as the allocation of tax savings in filing a joint return. The arm length’s criteria should not be a requirement for validity, nor should it have effect on the burden of proof, although between the two, it has greater appeal as the latter. To attempt to prove that a parent-subsidiary transaction was at arm’s length would be to attempt to prove a falsehood.

During the early 1900’s, contracts between a corporation and its non-control fiduciaries continued to be upheld if “fair, open, and known to the directors and stockholders.” In fact, the requirement of fairness was the only standard mentioned in one case. However, when the interested party was a parent corporation or other control entity, some doubt remained as to the legality of a transaction with the subsidiary due to the decision in Miner v. Belle Isle Ice. Corporations were finally given the right to contract with their subsidiaries in Stowe v. Hartford Fair Grounds Ass’n. Mr. Justice Butzel’s opinion contains no citations, yet this unanimous decision impliedly overruled Belle Isle Ice. Co. It is this type of incomplete opinion which has caused the uncertainty in Michigan’s law governing parent-subsidiary relations.

Stowe properly allowed a parent to deal with its subsidiary, but the parent’s duty of fairness to a subsidiary was paramount. This duty was enforceable by the corporation, the shareholders, and the creditors of the corporation.

Since 1931, a fiduciary has had statutory authority to contract with his corporation. The burden of proving fairness is expressly


49Brown Seed Co. v. Brown, 240 Mich. 569, 215 N.W. 772 (1927). Two other cases mentioned only the duty to act in “good faith” which is too indefinite to be used as the one general requirement. Thompson v. Walker, 253 Mich. 126, 234 N.W. 144 (1931); Bliss Petroleum Co. v. McNally, 254 Mich. 569, 237 N.W. 53 (1931). Note the similar difficulty in determining whether a holder of commercial paper took it in good faith to satisfy the requirements of a holder in due course. U.C.C. § 3-302.

5093 Mich. 97, 53 N.W. 218 (1892).

placed upon the party asserting the validity of the contract. This is set forth in M.G.C.A. section 13(5):

No contract of any corporation made with any director of such corporation or with a partnership of other group or association of which any such director shall be a member or with any other corporation of which such director may be a member or director and no contract between corporations having common director shall be invalid because of such respective facts alone. When the validity of any such contract is questioned, the burden of proving the fairness to the contracting parties of any such contract shall be upon the director, partnership, other group or association, or corporation who shall be asserting the validity of such contract.\(^{52}\) [Emphasis added].

Prior to the enactment of section 13(5), there was only the vague statutory duty to operate the corporation in "good faith."\(^{53}\)

The scope of section 13(5) is limited to contracts between a director and his corporation and contracts between corporations with interlocking directors. A parent company’s contracts with its subsidiary are clearly included. However, in addition to not applying to all fiduciaries, the statute applies only to “contracts,” and the scope of this term is not clear. It does include a chattel mortgage,\(^{54}\) but it does not include some other aspects and agreements of a parent-subsidiary relationship. For example, a subsidiary might allow a parent corporation to examine its customer lists without charge if the parent were seeking customers for a complementary product. It is doubtful whether section 13(5) applies to that situation; it would be covered by the general rules of the common law, however.\(^{55}\)

\(^{52}\)MICH. COMP. LAWS § 450.13(5) (1967).
\(^{53}\)MICH. COMP. LAWS § 10020 (1929).

Section 13(5) requires that a party seeking to uphold the contract’s validity bear the burden of proving requisite fairness. It is uncertain whether the legislature intended to make fairness the only requirement for a contract’s validity. In the author’s opinion, this was not the legislature’s intention. Section 13(5) only states who should bear the burden of proof if the requirement of fairness is imposed by law other than that found in section 13(5). Thus, section 13(5) merely codified two aspects of the existing law: that such contracts are not void, and that any prerequisite of fairness which might be required by law outside of the section would have to be proven by the party asserting fairness.

While M.G.C.A. section 13(5) covers contracts in general, M.G.C.A. section 46 regulates loan contracts. Section 46 forbids loans to officers, directors, and stockholders by non-financial institutions unless the loans are approved by a two-thirds majority of directors excluding any director obtaining such loan. The statute contains no requirement of fairness; yet a recent Michigan Supreme Court decision wrote of subjecting a section 46 loan from a subsidiary to a parent to the general standard of fairness under the common law and under section 13(5). This requirement is further evidence that the common law has not been supplanted but merely supplemented by statute. Curiously enough, loans from parent to subsidiary are not covered by the terms of section 46. Rather, they are treated as any other contract between the two and come within the ambit of section 13(5).

A sale or lease of less than substantially all of a corporation’s assets to a fiduciary is covered by the common law and by M.G.C.A. section 13(5). Where the sale or lease encompasses substantially all of a corporation’s assets, the sale or lease must comply with M.G.C.A. section 57. Section 57 removes the decision-making power as to sale or lease from the hands of the directors and places it into the hands of the majority of each class of stock. This removal does not necessarily mean that a parent or

57MICH. COMP. LAWS § 450.46 (1967).
58Porter v. Porter Machinery Co., 336 Mich. 437, 58 N.W.2d 135 (1953). This was a 4-3 decision with the minority only requiring that a lack of fairness be proved.
other control party can, by complying with section 57, avoid any liability where the terms of the sale or lease are unfair to the controlled corporation. Michigan decisions appear to uphold M.G.C.A. section 57 transactions unless there is an actual fraud perpetrated by the majority against the minority shareholders. A fiduciary, however, should not be excused from the obligation to enter only into relations with his corporation which are fair to the latter as the Michigan decisions apparently allow him to do. It is the board of directors which must propose a sale or lease of substantially all of the corporation’s assets under M.G.C.A. section 57. No proposal should be sent to the shareholders for approval unless it is fair or unless its lack of fairness is explained. This point has not been made clear in Michigan decisions.

3. A New Definition of Fairness

To characterize a relation as fair is to impute to it many attributes. A fair relation is impartial, just, unbiased, equitable,

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60 See also Voight v. Remick, 260 Mich. 198, 244 N.W. 446 (1932).
61 Porter v. Porter Machinery Co., 336 Mich. 437, 58 N.W.2d 135 (1953). The problem of a parent’s direct duty to minority shareholders, rather than to the corporation, is not within the scope of this article. However, one observation concerning that duty is in order. The Michigan legislature has provided, in Mich. Comp. Laws § 450.44 (1967), that shareholders dissenting from a Mich. Comp. Laws 450.57 (1967) sale or lease possess the right to receive the fair cash value of their shares. Section 44 provides the sole remedy to such minority dissenting shareholders under the Mich. Comp. Laws, even though unfairness may be present in the transaction. The Michigan Supreme Court in Porter has upheld the exclusiveness of § 44’s remedy. Since Mich. Comp. Laws §§ 450.52-54 (1967) governing mergers and consolidation has language similar to Mich. Comp. Laws § 450.44,57 (1967), presumably the same exclusivity of remedy applies. Accordingly, dissenting shareholders will be held to their statutory appraisal remedy unless they can prove fraud.
62 It is worthwhile noting that the “fairness” doctrine alone might serve as adequate protection for minority shareholders. One note written in 1938 stated that the majority rule was that such challenged contracts were valid if fair with the directors having the burden of proof. Note, Judicial Interference with Intercorporate Transactions, 38 Colum. L. Rev. 348 (1938). Another author wrote in 1948, “And in cases involving interlocking directories, fairness is always the measure of the validity of the contract, whether the majority is interested or not.” Note, The Fairness Test of Corporate Contracts with Interested Directors, 61 Harv. L. Rev. 335, n. 10 (1948). See also Note, The Validity of Contracts Between Corporations with Common Directors, 51 Harv. L. Rev. 327 (1937).
reasonable and evenhanded.\textsuperscript{63} It is doubtful that there can be a completely fair relation between a subsidiary corporation and its control parties and fiduciaries. The latter, in all likehood, would be favored by the subsidiary over outsiders. More often than not, some pressure will be exerted on the corporation to deal with the parent. This pressure will not necessarily be as flagrant as open reciprocity practices, where the parent or fiduciary only buys from the corporation as long as the corporation buys from it, but common sense dictates that pressure will exist. Michigan law has recognized the need of a corporation to seek help and deal with its fiduciaries since fiduciaries often have the greatest interest in the corporation's welfare.\textsuperscript{64} At the same time, the law has considered valid only those relations between a fiduciary and its corporation which are fair. The word "fair," however, does not have a commercial meaning and needs clarification. Business fiduciaries require an interpretation of this concept that can be applied with a degree of predictability; "good faith" and "arm's length" are criteria too vague to be relied upon.

The author suggests a definition of fairness based upon commercial realities; that is, a fair parentsubsidiary relation is one whose terms are within that range of terms which would be assented to by a reasonable businessman acting solely for the benefit of a corporation after that businessman has considered all aspects of the relation.

A temptation exists to use a market test as the definition of fairness. Under such a test, a fair relation would be one within the range of terms acceptable to the subsidiary corporation if offered by a party who was unconnected with, and had no power over, the corporation. To apply such an open market test when the situation may be one of a closed market is not realistic. The market for a subsidiary's goods may be closed to all except the parent upon the explicit direction of the parent. Proof that a relation has terms found in the market place is one way to commercially justify it, but it should be the only means.\textsuperscript{65}

\textsuperscript{64}Mich. Comp. Laws § 450.13(5) (1967).
\textsuperscript{65}There has been substantial activity in state legislatures and courts on the standards for judging intercorporate transactions. Note, The Fairness Test of Corporate Contracts
B. Disclosure

The first Michigan decision to uphold contracts between a corporation and an interested fiduciary, *Aldine*, required that such agreements be "open . . . and known to the officials of both companies." This disclosure must include all terms of the relation which are material; that is, all terms which are relevant to a shareholder's or director's decision to challenge a relation for a lack of fairness. The disclosure requirement has, however, had a varied existence. Courts have ignored the lack of disclosure in some cases, used it as evidence of a lack of fairness in others, and found it sufficient to give relief in still others. The parties to whom disclosure should be made remains unclear. Some decisions require disclosure to stockholders and directors whenever a fiduciary deals with his corporation, while others require only that the directors be completely informed of the transaction.

with *Interested Directors*, supra note 62. For example, California allows unfair contracts if approved by a majority of the disinterested shareholders. *CAL. CORP. CODE* § 820 (West 1962). But cf. *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App.2d 405, 241 P.2d 66 (1952). At least one court has allowed one-sided contracts where this was contemplated and accepted by all involved. *Everett v. Phillips*, 288 N.Y. 227, 234, 43 N.E.2d 18, 20 (1942). A Michigan decision could be construed to allow directors to avoid their fiduciary duties in dealing with the corporation if such was provided for in the articles of incorporation. *Voight v. Remick*, 260 Mich. 198, 244 N.W. 466 (1932). *DEL. CODE ANN* tit. 8 § 144 (1953) permits parent-subsidiary relations without proof of fairness where there is proper ratification. See also German Stock Corporation Act which contains unique features regulating parent-subsidiary relations. F. JUENGER & L. SCHMIDT, GERMAN STOCK CORPORATION ACT, Book III, (1967).

67*Young Spring & Wire Corp. v. Falls*, 307 Mich. 69, 11 N.W.2d 329 (1943).
67*Young Spring & Wire Co. v. Falls*, 307 Mich. 69, 11 N.W.2d 329 (1943); *Reitz v. Owosso Finance*, 369 Mich. 408, 120 N.W. 175 (1963); *Sant v. Perronville Shingle Co.*, 179 Mich. 42, 146 N.W. 212 (1914). One well known Michigan authority has stated, "The non-disclosure of his adverse interest is not necessarily fraud, actual or constructive, though it is a circumstance to be considered." R. M. SCHMIDT & Z. CAVITCH, MICHIGAN CORPORATION LAW WITH FEDERAL TAX ANALYSIS § 2.52(1) (1969). In view of the three cases just cited, however, any advice to a client not to disclose is risky.

The requirement of disclosure has not been expressly eliminated by M.G.C.A. section 13(5) as it relates to contracts, or by section 57 as it relates to the sale or lease of substantially all of the subsidiary's assets. These sections, however, do not embrace the requirement either. The common law requirement of disclosure should not be read out of Michigan law by a narrow construction of these two sections. Section 46, on the other hand, has its own disclosure provision. This section requires that all shareholders be given an annual report of all loans to shareholders, officers and directors.

Expanded disclosure requirements would enable the minority to better protect its interests by providing them with current information on interested fiduciary relations. However, there are drawbacks to such a requirement. One such disadvantage is the cost. Companies already sending out proxies and annual reports would not be excessively burdened. However, small corporations that are not already sending out such materials may find the cost difficult to absorb. A second and more telling objection to expanded disclosure is the natural and justifiable business desire for internal security. To make public a record of intercorporate transactions would be a significant benefit to a firm's competitors.

One writer maintains that the requirement of disclosure in a parent-subsidiary situation "is both unnecessary and misleading." This is so, he reasons, because disclosure is useless where the recipients of the disclosed facts are powerless to act, as would be the case with minority directors. However, this position is unacceptable. The minority shareholders and directors are not powerless to act. Shareholder derivative suits are available to them, and disclosure would enable them to better police the majority. In addition, requiring disclosure of all transactions to minority directors might prove to be a psychological block to flagrant abuses of the subsidiary. It would appear, therefore, that disclosure to the shareholders should be required.

Indeed, requiring disclosure is a necessity if the law is truly concerned with overreaching by control parties and other

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fiduciaries. A transaction can hardly be challenged as unfair if the board and the shareholders are unaware of it. The cost of disclosure can be minimized by requiring disclosure only in those documents already required by law, such as annual reports to the Secretary of State’s office and to the shareholders. It is undoubtedly true that disclosure infringes on corporate secrecy, but that is unavoidable and, in the case of parent-subsidiary relations, most desirable in promoting fairness.

C. Approval by Ratification

1. Common Law Ratification

A transaction between a parent and its subsidiary that is voidable because it is unfair is valid if ratified by all of the subsidiary shareholders. This ratification is effective only as to the shareholders and does not bind other parties such as creditors. Moreover, one Michigan case at least implies that a unanimous stockholder vote would ratify even a fraudulent or illegal act perpetrated upon the corporation. However, the effect of a ratification by the subsidiary’s directors of a breach of fiduciary duty, as opposed to an illegal or fraudulent act, is unclear under Michigan law. If the directors are the only shareholders, a unanimous ratification vote by the directors is the same as a unanimous shareholder vote. An unfair transaction approved in this manner could not be challenged by a shareholder or director since both groups have unanimously ratified.

It has been said that there can be ratification only where the corporation could have initially entered into the transaction. This rule would seem to preclude ratification of a transaction which is not fair to the corporation, whether it is with a subsidiary or not. However, the Michigan rule allowing ratification of unfair

transactions by unanimous stockholder action is one exception to this rule.\textsuperscript{79} This exception should not be broadened to include a less than unanimous vote by shareholders or a unanimous vote by directors who are not the sole shareholders. Despite slight Michigan authority to the contrary,\textsuperscript{80} shareholders and directors should not be precluded from challenging a transaction for unfairness despite approval by their fellow shareholders or directors.\textsuperscript{81}

In addition to those cases holding that ratification may validate an unfair contract, there are two decisions holding that ratification, as well as fairness and disclosure, is a requirement for validity of a parent-subsidiary transaction.\textsuperscript{82} In \textit{Veeser v. Robinson Hotel Co.},\textsuperscript{83} the court required ratification on the basis of a possible, although incorrect, interpretation of an earlier case.\textsuperscript{84} In the only case in which this requirement has been urged during the twenty-five years since \textit{Veeser}, a federal court stated that it was "...doubtful whether Michigan would even recognize the principle of the \textit{Veeser} case today..."\textsuperscript{85}

The viability of \textit{Veeser} was finally reconsidered in \textit{Buck v. Northern Dairy}.\textsuperscript{86} A former president, director, and owner of a

\textsuperscript{79}See text accompanying note 76 supra.
\textsuperscript{81}Wilbur v. Stoeppel, 82 Mich. 344, 46 N.W. 724 (1890).
\textsuperscript{83}275 Mich. 133,266 N.W. 54 (1936).
\textsuperscript{84}Vesser misread Patrons' Mutual Fire Insurance Co. v. Holden, 245 Mich. 493, 222 N.W. 754 (1929), as requiring ratification \textit{in addition} to fairness and disclosure, rather than as an alternative to fairness. The Patrons' court, in its statement of applicable law, unfortunately construed two sections of 14A as one. Section 1887, stating the rules when a contract is invalid for a breach of trust, was combined with language from § 1888 dealing with how a relation, voidable for a breach of trust, could be saved by ratification. Poor citation in the official Michigan reporter most likely led the court in \textit{Veeser} to read Patrons' as requiring no breach of trust plus ratification if a fiduciary's relations were to be upheld. The \textit{Veeser} court would have been on firmer ground if it had relied upon Ten Eyck v. Pontiac, O. & P.A.R.R., 74 Mich. 226, 41 N.W. 905 (1889), to support its holding making ratification a requirement.
\textsuperscript{86}364 Mich. 45, 110 N.W.2d 756 (1961).
controlling interest in the defendant corporation had sued for specific performance of a "retirement annuity agreement." A circuit court judge granted the relief prayed for, and the defendant appealed. The lower court's decree was affirmed by an equally divided court. The Michigan Supreme Court was divided on two points.

The four justices for reversal voted to overrule *Veeser* and its requirement that a quorum of disinterested directors approve the transaction. The four justices for affirmation implied that *Veeser* was still good law, but that its requirements would be satisfied by approval by a majority of the disinterested directors, whether or not they constituted a quorum. Such a position poses serious difficulties for parent-subsidiary relations. As those who favored overruling *Veeser* stated:

Indeed, if the principle of the *Veeser* case is applied to contracts between corporations having common directors (e.g., parent and subsidiary corporations, where, not infrequently, a majority of the members of one Board serve on the Board of the other), would we not be compelled to say such contracts are likewise void (not merely voidable) regardless of their fairness to each corporation?  

The author agrees that such a decision would be compelled by the philosophy of *Veeser*. However, it seems clear that the acceptance of *Veeser* by the four justices was improper. The *Veeser* decision itself resulted from a misinterpretation of the *Patrons* decision.  

Also, the *Miner* decision, which was heavily relied upon by the *Veeser* court, had been substantially weakened, if not overruled, by *Hartford Fair Grounds Association*. Moreover, the *Veeser* decision is contrary to the weight and trend of Ameri-
can authority. The usual rule is that ratification is a *substitute* for fairness, and not an additional requirement.\(^9\)

In addition, *Veeser's* requirement that there be approval by a quorum of disinterested directors is inimical to the needs of the parent-subsidiary relation. Such a requirement unnecessarily restricts the doctrine of majority rule without providing any significant increase in protection.

The decision in *Buck* is even more difficult to understand when considered in the light of *Thomas v. Satfield Co.*\(^9\) The *Thomas* case was decided only five months prior to the *Buck* case, yet it reformed a transaction between two corporations with common directors and stockholders by reducing the price paid by the subsidiary corporation to its fiduciary solely on the basis of a lack of fairness. No mention of approval by disinterested directors (there were two) was made by the unanimous court in reforming the contract. It is difficult to understand the sudden change of heart exhibited by the pro-*Veeser* forces in the *Buck* decision. The *Veeser* decision requirement of ratification has been ignored since 1961,\(^9\) but it remains a threat to all parent-subsidiary relations.

Whether ratification is a permissive procedure to protect fiduciaries or a requirement for a valid relation between a corporation and a fiduciary, some discussion of what constitutes ratification is necessary. The author has discovered few specific Michigan rules concerning stockholder ratification. At common law, a single shareholder could stop a sale of substantially all of the corporation's assets.\(^9\) The statutory change in this rule will be discussed shortly. While unanimous shareholder action can ratify an unfair contract, the effect of ratification by less than all shareholders is unclear. Where a non-fraudulent transaction is to be ratified, a majority or statutory percentage of the shareholders may have the power to ratify.\(^9\)

\(^9\)See 18 C.J.S. Corporations § 778(b).
\(^9\)Crowe v. Consolidated Lumber Co., 239 Mich. 300, 214 N.W. 126 (1927) (See discussion accompanying note 86 supra.)
Parent-Subsidiary Relations

Director ratification consists of affirmative approval by a majority of an interested quorum of directors, or approval by a majority of the disinterested directors whether or not they constitute a quorum. If ratification remains a requirement under Michigan law, the author suggests that ratification by directors consist of a majority of all disinterested directors whether or not the total disinterested directors constitute a quorum. This rule would permit ratification of relations between a parent and a subsidiary or other controlling shareholder. In those situations in which there are only interested directors, since ratification would not be possible, it would not be a prerequisite to a valid parent-subsidiary transaction.

2. Independent Agent Ratification

A doctrine noted in a few Michigan cases, which might be termed “independent agent ratification,” permits validation of a contract between a parent and a subsidiary where the subsidiary is represented in the negotiations by independent, outside agents. This type of informal, or pre-contractual, ratification is also effective when disinterested directors of the subsidiary are the negotiators. This form of ratification can prove to be a useful maneuver when a parent controls all of the directors of the subsidiary, or when minority directors of the subsidiary are hostile to the parent. In the former case, ratification can be obtained by employing outside agents; in the latter case by employing the minority directors as negotiators.

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97Buck v. Northern Dairy, 364 Mich. 45, 47-48 110 N.W.2d, 761-62 (1961). Although the disinterested directors constituted a quorum in Buck, supra, the court did not require such a quorum in its statement of the law.
98Whichever decision one reads determines which of the two possible rules one will follow.
101Loomis, A Squeeze on Directors, FORTUNE, May 15, 1969, at 146.
Outsiders negotiating a transaction between a parent and a subsidiary would themselves become fiduciaries and thus become subject to the same standards and liabilities as other fiduciaries. No Michigan decision has dealt with this problem. It is clear, however, that such persons should be held accountable as fiduciaries insofar as they are acting as protectors of the interest of the subsidiary which has no other way to defend itself in its dealings with its normal fiduciaries.102

3. Statutory Changes

The relevant statutory changes in Michigan common law are found in two sections of the M.G.C.A. These changes are section 46 (loans to officers, directors, and shareholders) and section 57 (sale or lease of substantially all of the corporation’s assets). No attempt has been made to establish by statute any general rules as to the effect and proper manner of ratification.

A sale or lease of substantially all of a corporation’s assets can only be completed under authority granted by a majority of the shareholders.103 The articles of incorporation may increase the percentage required for approval. Subject to any provisions incident to the authority granted by the shareholders, the directors have the right to set the terms of sale as long as the terms are “expedient and for the best interest of the corporation.”104 [Emphasis added.] Although the statute mentions only protection of the corporation, the courts have determined that any resulting sale must not be fraudulent as to minority shareholders.105 A recently enacted statute provides that, unless otherwise stipulated in a corporation’s by-laws or articles, the board of directors may authorize a pledge or mortgage of all or any part of the firm’s assets without stockholder approval.106

102 Stockholder ratification could be an expensive procedure. It may also be impracticable since Michigan requires a 100 percent ratification vote before a shareholder is precluded from challenging the transaction.
When a sale of all of a firm's assets to a corporate fiduciary is proposed, the interested party will, no doubt, desire to vote his shares. Section 57 is silent on this point, but under the common law, he should be able to vote subject to a duty not to vote for a proposal or a grant of authority where the financial interests of other shareholders would be unfairly injured. Generally, a shareholder may not object to a sale or lease under section 57 unless there has been fraud, or an attempt to alter a vested right. Mere proof of unfairness is insufficient to prove a breach of fiduciary duty unless the voting fiduciary's votes were required for passage. A dissenter's sole remedy is normally redemption of his stock for its fair cash value under section 44.

Section 46 prohibits loans by non-financial corporations to shareholders, directors and officers unless approved by the directors. Such approval must be by a "...vote of at least \( \frac{2}{3} \) [two-thirds] of all the members of the board of directors of the corporation excluding any director obtaining such loan..." It is not clear whether the clause "excluding any director obtaining such loan" modifies "the vote of at least two-thirds," or "all of the members," or both phrases. A cogent argument can be made for each of the three possibilities. The statute should be read as requiring approval by two-thirds of all disinterested directors. Such an interpretation avoids any possibility of an interested director voting upon the resolution, and it also allows loans where more than one-third of the directors are interested in the matter.

A second problem concerning the interpretation of section 46 is the meaning of the phrase "excluding any director obtaining such loan." A question arises whether a director controlled by a parent corporation may vote upon a proposed loan to the parent. Applying the rule that the controlled party is merely a puppet of the controller, such a director should not be allowed to vote to grant the loan. This result is proper since to

allow otherwise would emasculate the statute by permitting the fiduciary to approve loans to himself contrary to the apparent intent of the statute. Therefore, loans by a subsidiary to a parent corporation must be approved by a $2/3$ vote of all directors not controlled by the parent.\footnote{112}{c.f. Fenestra, Inc. v. Gulf Land Development Corp., 377 Mich. 565, 141 N.W.2d 36 (1966).} If a loan is not made according to this procedure, it is not *ipso facto* void, but merely voidable in favor of the corporation.

**VI. Remedies for Breach of Duty Owed by Parent or Other Corporation Fiduciary.**

*A. Equity*

Courts of equity have jurisdiction over any alleged violation of duty to the corporation.\footnote{113}{Id.; and *In re* Wood's Estate, 299 Mich. 635, 1 N.W.2d 19 (1941). *See also* Mich. Comp. Laws § 450.47 (1967).} However, equity courts will not assume jurisdiction where there is merely dissatisfaction among the shareholders since one requirement of jurisdiction is that there be fraud or breach of duty.\footnote{114}{Turner v. Calumet & Hecla Mining Co., 187 Mich. 238, 153 N.W. 718 (1915). For an example of legal remedy used to protect the corporation see note 113 *supra*; *Holden v. Lashley-Cox Land Co.*, 316 Mich. 478, 25 N.W. 2d 590 (1947). Equitable relief is also open to creditors and the corporation itself. *Wiseman v. United Dairies*, 324 Mich. 473, 37 N.W. 2d 174 (1949).} When an accounting is necessary, relief is more likely to be granted than when an injunction or other non-monetary relief is required. An early Michigan decision held that equity will act "when the evil is apparent" and will not "await the consummation of the threatened wrong."\footnote{115}{Turner v. Calumet & Hecla Mining Co., 187 Mich. 238, 153 N.W. 718 (1915) (The "wrong" was domination for parent's benefit).} A recent Michigan Supreme Court opinion, while not expressly rejecting these earlier statements, required that plaintiff prove imminent danger or an illegal act before an injunction will issue.\footnote{116}{Fenestra, Inc. v. Gulf Land Development Corp., 377 Mich. 565, 141 N.W. 2d 36 (1966) (also holding an impending take-over is not a "danger"). *Wagner Electric Corp. v. Hydraulic Brake Co.*, 269 Mich. 560, 257 N.W. 884 (1934) (will only grant injunctions to prevent irreparable harm).}
when monetary damages were inadequate to protect a corporation from its fiduciaries. A common method of relief is refusal to enforce a contract made in violation of fiduciary duty. This type of relief is easy to grant and supervise, but it is not always sufficient or applicable. The courts are restrained in their infringement of the traditional rights of shareholders, directors and officers, but they are nonetheless willing to draft decrees equal to the task of discouraging or preventing future improprieties.

B. Damages.

Monetary relief may include damages, interest, and costs. The measurement of damages is a very troublesome procedure. Damages may not be speculative. It is unclear under Michigan law whether damages may include profits made by a fiduciary in breach of his duty when there has been no actual present loss or loss of opportunity. A federal court interpreting Michigan law has held that such profits must be turned over to the corporation since they constituted unjust enrichment. It is proper to award dam-


121Pergament v. Frazer, 93 F. Supp. 13 (1950). "It does not appear that Kaiser-Frazer was damaged by the transaction nor was it deprived of any profit which it otherwise should have had, but there was unjust enrichment to Frazer as a result of the board's action". Id. at 37. The author has not found a Michigan case on this point. Nor has a case been discovered adopting the rule of Mosser v. Darrow, 341 U.S. 267, 95 L. Ed.
ages where a relation is unfair, and it may be argued that a relation is unfair when the corporation does not receive the market value for the benefit it gratuitously bestowed on its fiduciary. When there is no actual present loss or loss of opportunity, however, the measure of damages should be the fair market value of the benefit, not the fiduciary's profit.

When the fiduciary steals a business opportunity of his corporation, he must surrender his profits. The rule has been referred to in Michigan and elsewhere as the doctrine of "secret profits." The usual measure of damages in cases not involving the theft of a corporate opportunity is the difference between the fair market value of the benefit received by the corporation through the relation, such as goods, office space, use of mailing lists, and that given by the corporation. The proper situation in which to use the alternative measurements of damages, "secret profits," remains unclear. One court has attempted to clarify this issue:

   When directors sell their own property to a corporation, through their own action or influence as officers, or without disclosing their interest, and the corporation does not repudiate the purchase and rescind, the directors are liable not upon the theory of secret profits (citation omitted); but for fraud or excessive price, and the measure of damages is the difference between the price paid by the corporation and the fair value of the property (citation omitted).

   . . . If they purchase personally, with the intention to sell to the corporation, or while purporting to act as corporation officers, the whole benefit of the purchase inures to the corporation and the rule of secret profits applies. In such case, the rule of damages is that directors would be liable for the price paid by

927, 71 S. Ct. 680 (1951), holding a trustee (in bankruptcy) liable for profits made by his employees.


the corporation less the cost of the lease to them.\textsuperscript{124}

The proper measure of damages, therefore, depends upon the intent and the capacity in which the corporate fiduciary acts at the time he acquires the property which is later sold to the corporation. Where the challenged act is a purchase from the corporation rather than a sale, the measure of damages is the fair value of the property less the price paid.\textsuperscript{125}

Prior to 1961, the question of fairness was thought to be measured as of the date on which the relation began.\textsuperscript{126} Then, in \textit{Thomas v. Satfield Co.},\textsuperscript{127} the court measured fairness as of the time of the corporation's performance. The corporate fiduciary was to build a bowling alley for the corporation for a fixed price. The court reformed the price in the contract to make the fiduciary's profit percentage equal to the figure which parole evidence indicated the corporation wanted the fiduciary to realize. The fiduciary was thwarted in his efforts to minimize his costs of performance in an attempt to make more on the fixed price contract. His efforts not only failed to increase his earnings, but they resulted in decreased dollar profits, though not in a decreased percentage. In effect, the court applied a modified "secret profits" rule, restricting an allegedly agreed upon amount. Such protection by reformation seems unnecessary. The question should be whether the initial terms were fair at the time the relation was entered into. Courts should not go beyond the original expectations of the corporation.

The liability of directors who are disinterested, but who abstain from voting or who are not in attendance during deliberations or voting, has not been decided in Michigan.\textsuperscript{128} It is well established,

\textsuperscript{124}Id. at 573, 237 N.W. 55.


\textsuperscript{126}Brown Seed Co. v. Brown, 240 Mich. 569, 215 N.W. 772 (1927). \textit{See also} Pergament v. Frazer, 93 F. Supp. 13, 23 (E.D. Mich. 1950), "We also hold that we should apply the law and view the transaction in the light of the facts existing at that time; not what happened later."


\textsuperscript{128}\textit{See} Globe Woolen Co. v. Utica Gas & Electric Co., 224 N.Y. 483, 121 N.E. 378 (1918) (abstention does not satisfy duty to exercise positive judgment).
however, that a director voting for an unfair proposal, as well as the parent corporation, is liable even though his vote is controlled by the parent. A director’s right to contribution from those who joined him in his breach of duty has not yet been decided in Michigan.

The allowance of interest on the damages is within the discretion of the courts. Interest computed from the time of the decree or the time of the wrong has been granted.

Costs usually are awarded to the winning party. Attorneys’ fees are only awarded where a derivative suit is successful.

VII. Conclusion

Michigan law governing relations between subsidiaries, their parents, and other interested fiduciaries is both confused and, in some instances, unnecessarily restrictive. This indefiniteness calls for a complete examination of the law in this area. The author has suggested a number of changes which may result from such an inquiry.

Eliminating the doctrine of corporate control is central to reforming the law governing parent-subsidiary relations. Emphasis should be refocused on the duty owed by all corporate-fiduciaries, whether they are officers, controllers of one director, or in unchallenged control of the board.

More precise standards are required for determining the validity of parent-subsidiary relations. The present standard of fairness does not provide definite criteria by which corporate officials can predict the validity of a proposed relationship. The ratification procedure is well-suited to provide a more objective standard. A hesitant parent or other fiduciary should submit a particular rela-

131Young Spring & Wire Co. v. Falls, 307 Mich. 69, 11 N.W.2d 329 (1943).
132Young Spring & Wire Co. v. Falls, 307 Mich. 69, 11 N.W.2d 329.
tion, regardless of its fairness, to the interested board members or shareholders for approval. Interested parties, whether directors or shareholders, should not be permitted to vote, although they may be counted towards a quorum. Approval by a majority of those allowed to vote would, in the absence of fraud, validate the proposed relation.

To enjoy the advantages of ratification, the electorate must be informed; thus, complete disclosure of the relation’s terms must be made. Although disclosure of all parent-subsidiary relations and their terms would place a heavy administrative burden on many parents and their subsidiaries, it is necessary for the corporation, its minority directors, and shareholders to receive this information to prevent its fiduciaries from overreaching. A balance might be struck by providing for notice of parent-subsidiary and other fiduciary relations and their major terms in the annual report to the shareholders, or, if none is made, the annual report to the Department of the Treasury. Thus, shareholders and directors would have an opportunity to decide if further inquiry was necessary. At the same time, the amount of disclosure to competitors could be minimized.