THE CORPORATE OPPORTUNITY DOCTRINE[†]

By

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The corporate opportunity doctrine ("COD") is a common law doctrine that limits a corporate fiduciary's ability to pursue new business prospects individually without first offering them to the corporation. Conflicts over allocation of corporate opportunities constitute particularly thorny questions in corporate law, since the parties' respective interests are not merely misaligned, but are rather in profound contradiction to one another. In addition, COD conflicts are likely in situations where two or more firms share common officers and/or directors, and particularly within the parent-subsidiary context. Formally, the doctrine is a subspecies of the fiduciary duty of loyalty, and it has been a mainstay in the corporate precedents of virtually every state for well over a century (notwithstanding the existence of several doctrines that similarly restrict the appropriation of corporate property by fiduciaries[1]). Nevertheless, the precise contours of the doctrine remain somewhat elusive, and, perhaps consequently, its application is widely thought to be unpredictable.

This article briefly summarizes the principal features of the COD, offering what amounts to a "doctrinal anatomy" of typical claims, and reviewing recent statutory developments. We conclude with some brief descriptions of a number of important precedents. Although the focus below is predominantly on Delaware law, we shall also point out at various junctures where other jurisdictions (such as California) diverge.[2]

Who Is the Principal Target of the COD?

Although many of the constituent sub-doctrines comprising the fiduciary duty of loyalty overlap considerably, what immediately distinguishes the COD in practice is its

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[1] Others include the duty not to compete with the corporation, the duty not to appropriate trade secrets, and the duty not to act as an adverse party in transactions with the corporation. These doctrines are not addressed here. For more on their relationship with the COD, see Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 Yale L. J. 299 (1998).

[2] Interestingly, California courts have produced a relatively anemic corpus of COD jurisprudence. Thus, the more robust developments of late outside California may well prove instructive even in litigation involving California corporations.

relatively targeted scope. Indeed, the COD pulls within its ambit duties that extend *predominantly* to corporate directors and officers, but *generally not* to other agents, employees, or stakeholders in the firm.[3] This observation is significant, because it suggests that the underlying motivation behind the COD has relatively little to do with day-to-day incentive problems on the proverbial factory floor. On the contrary, officers and directors play little or no direct role in routine production operations. Rather, what these corporate fiduciaries appear jointly to share from an agency-cost perspective is a macro-organizational role as "gatekeepers." Unlike rank-and-file employees or mid-level management, directors and officers play a predominant role in evaluating the relative merits of prospective new business projects, recommending which the firm should pursue and which it should eschew.[4] It therefore seems plausible (if not likely) that one of the primary purposes of the COD is to address incentive problems that are unique to this gatekeeping function.

Who Is Eligible to Bring a COD Action?

Formally, it is the corporation that benefits from a fiduciary's duty of loyalty. Thus, in most instances, the corporation must itself assert its rights against a current or (more typically) former officer or director who has usurped an opportunity. Nevertheless, shareholders may also attempt to make use the derivative action to compel an unwilling board to assert a corporate opportunity claim. In such instances, the familiar constraints on derivative actions (such as demand futility requirements, and, where applicable,

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[3] *See* LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS (3d ed. 1996), at 546-47. It should be noted that on occasion, the COD has been applied to other relationships of trust and confidence within the firm. *See, e.g.,* A. Teixeira & Co. v. Teixeira, 699 A.2d 1383, 1387 (R.I. 1997) (holding that the COD applies to a shareholder not affiliated with management if that shareholder actively participates in management decisions).

[4] This information-processing role is widely recognized in the corporations literature. The following excerpt from Robert Clark is typical:

> [A] very large portion of any manager's job consists of gathering, evaluating, relating, and dispensing pieces of *information*. He or she is an information processor par excellence. The term *information* is used here in a broad sense: it includes not only bits of factual data, judgments, opinions, and predictions, but also requests, advice, and commands within a firm, and bids and offers among those who potentially might make a deal of some sort. Included within the manager's information processing tasks is the activity of making business *decisions* . . . .

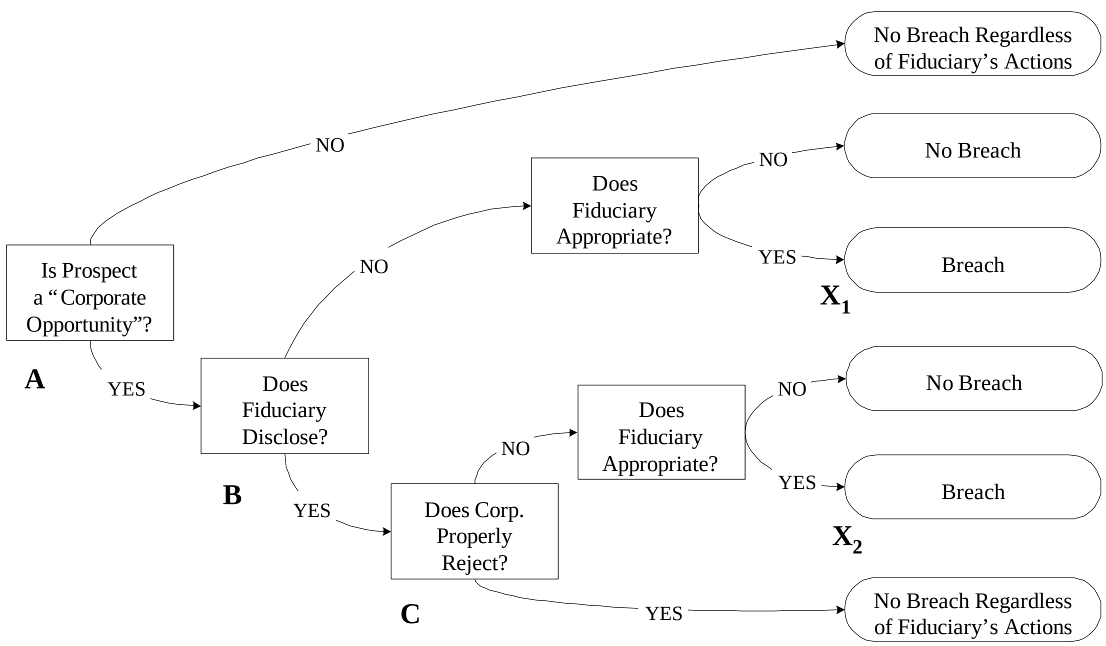
ROBERT CHARLES CLARK, CORPORATE LAW 802-03 (1986). Though one's initial inclination is to ascribe these gatekeeping duties primarily to officers and inside directors, there is mounting evidence that outside directors are increasingly playing a similar role. *See, e.g.*, Hobson Brown, Jr., *What Do Institutional Investors Really Want?*, CORP. BOARD, May 1996, at 5; Robert H. Campbell, *Directors: 'The Brokers of Balance,'* DIRECTORS & BOARDS, June 1996, at 45; Robert F. Felton et al., *Building a Stronger Board*, MCKINSEY Q., Mar. 22, 1995, at 162; Keith J. Louden, *A Position Description for the Board*, DIRECTORS & BOARDS, Mar. 22, 1993, at 23.

minimum holding requirements and the posting of security for expenses) continue to apply.[5] Typically, such claims are uniquely derivative in nature, and are therefore difficult to categorize as direct.[6]

What is the Basic Structure of a COD Dispute?

Most modern corporate opportunity disputes follow a facially simple analytical algorithm, represented below by Figure 1:

FIGURE 1. A SIMPLE ROAD MAP OF THE CORPORATE OPPORTUNITIES DOCTRINE



The figure presupposes that a new business prospect has recently been presented to a corporate fiduciary, and it traces the parties' subsequent actions along with the legal consequences thereof. The first relevant legal inquiry occurs at node *A*, where a court must determine whether the project in question constitutes a "corporate opportunity." If not, the legal inquiry ends: Absent express language to the contrary in the corporate charter or employment contract,[7] the fiduciary may pursue the prospect at will. On the other hand, if a corporate opportunity is found to exist, the inquiry proceeds to node *B*, where the court attempts to ascertain whether the fiduciary has fully disclosed the opportunity (along with her interest in it) to the corporation. If she has not, then any

[5] *See, e.g.*, CAL. CORP. CODE § 800 (1999).

[6] *See, e.g.*, *In re*: Digex Inc. Shareholders Litigation, 2000 WL 1847679, at *10 (noting that "[a] claim that a director or officer improperly usurped a corporate opportunity belonging to the corporation is a derivative claim").

[7] Whether an action of the corporation can expand and/or limit the reach of the COD is taken up at greater length below.

authorization, approval, or ratification by the firm is voidable, and an appropriation of the project by the agent constitutes a breach of fiduciary duty. Conversely, if the fiduciary discloses fully, the inquiry proceeds to node *C*, where the corporation may "reject" the tendered opportunity, thereby offering it back to the fiduciary. If rejection occurs, then the fiduciary may freely appropriate the project subject to the conditions (if any) attached to the rejection. On the other hand, if the corporation fails to reject (or it rejects "improperly"[8]), the fiduciary may not appropriate the project without incurring liability. Finally, at those terminal nodes X_1 and X_2, which signify a breach of fiduciary duty, a court imposes the appropriate remedy.

Although the structure of the above algorithm is easy to recite, its practical application has proven much more elusive than its rhetorical structure. While a comprehensive review of these difficulties is beyond the scope of this article, some of the important details found at each node are sketched out in the sections that follow.

What Sorts of Business Prospects Constitute Corporate Opportunities?

Typically, the first task for a court in a corporate opportunities case is to characterize whether the disputed project is, in fact, a "corporate opportunity." This single determination has proven to be the most confusing in practice, and jurisdictions (and even courts within the same jurisdiction) have oscillated among numerous characterization tests, summarized below. Perhaps reflecting the disarray that permeates current doctrine, the tests described below tend to overlap in a number of contexts.[9]

1. *The "Interest-or-Expectancy" Test*

The longest-standing characterization test for determining whether new business prospects are corporate opportunities turns on whether the corporation has an active commercial *interest* or *expectancy* in such opportunities. The "interest" component of this approach usually refers to projects over which the corporation has an existing contractual right.[10] The "expectancy" component includes projects that, while not already secured through an express contract, are likely, given current rights, to mature into contractual

[8] *See infra* text accompanying notes 39-42 (defining proper rejection).

[9] In fact, legal scholars have noted that courts will often pronounce one test and then proceed to apply another. *See, e.g.*, Pat K. Chew, *Competing Interests in the Corporate Opportunity Doctrine*, 67 N.C. L. REV. 435, 465-66 (1989), at 465-66.

[10] *See, e.g.*, Lagarde v. Anniston Lime & Stone Co., 28 So. 199 (Ala. 1900) (holding that corporate fiduciaries who purchased a two-thirds interest in a limestone quarry appropriated a corporate opportunity as to a portion of their purchase, since the quarry had already secured a contractual agreement from the seller for that portion). Some courts applying the interest-or-expectancy test have placed the additional requirement that the opportunity must be "necessary," "essential," or at least extremely important to the corporation before a court will deem there to be a prospective interest. *See* CLARK, *supra* note 4, at 226.

rights at some future date.[11] Of particular relevance here are so-called "relational" contracts between the corporation and repeat trading partners, in which periodic extensions are not expressly provided for but can be reasonably assumed.[12]

Notably, the interest-or-expectancy test ultimately defines a corporate opportunity largely by reference to *current* (rather than prospective) activities of the corporation. As such, the test provides a relatively predictable boundary. Indeed, the narrow reach of the test effectively limits it to those projects about which the firm (by virtue of its existing contractual rights) already has actual or reasonable knowledge. Despite its administrative convenience, however, the test has been criticized as under-inclusive because it reaches *only* those projects over which the corporation's proprietary claim is relatively mature.[13] Because many business projects do not reap rewards (in, say, the form of significant market share) until long after an initial investment, the argument goes, a characterization rule that protects only mature rights runs the risk of decreasing the ex ante incentives of the shareholders to invest in long-term projects.[14] As such, while virtually all jurisdictions still employ the interest and expectancy tests, they have been receptive to various expansions of the doctrine as well.

2. *The "Line-of-Business" Test*

Under the most prominent such extension, a new business prospect constitutes a corporate opportunity if it is deemed to fall within the firm's "line of business." According to most judicial accounts, this test pulls within its ambit any project that the corporation—given its assets, knowledge, expertise, and talents—could reasonably be expected to adapt itself to pursue *now or in the reasonable future.* The most often-quoted articulation of the test appears in the Delaware case of *Guth v. Loft, Inc.,* which characterized the inquiry as follows:

> Where a corporation is engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is

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[11] *See* CLARK, *supra* note 4, at 225; JAMES D. COX ET AL., CORPORATIONS 237 (1997) (describing the doctrine as unpredictable and noting that "a good deal of uncertainty exists as to what constitutes the usurpation of a corporate opportunity").

[12] Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under the Classical, Neoclassical, and Relational Contract Law*, 72 N.W. U. L. REV. 854 (1978).

[13] *See* CLARK, *supra* note 4, at 226-27 (noting that the interest-or-expectancy test is easier for executives to meet than other tests, and that its notion of duty is a negative conception, rather than an affirmative obligation); COX ET AL., *supra* note 11, at 237 (labeling the test as "lax" toward defendants); Chew, *supra* note 9, at 460. The narrow reach of the interest-or-expectancy test is illustrated in *Lagarde*, in which the Alabama Supreme Court held that "[g]ood faith to the corporation does not require of its officers that they steer from their own to the corporation's benefit, enterprises, or investments, which, though capable of profit to the corporation, have in no way become the subjects of their trust or duty." *Lagarde*, 28 So. at 202.

[14] *See, e.g.,* COX ET AL., *supra* note 11, at 237.

> adaptable to its business having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business. [15]

The line-of-business test (or a close variant) is now embraced by a significant number of jurisdictions,[16] and perhaps for good reason: Unlike its doctrinal forebear (the interest-or-expectancy test), the line-of-business test reaches beyond *current* contractual interests of the firm, and sweeps in prospective areas of growth as well, giving the doctrine a significantly more dynamic (and realistic) flavor.

Operationally, most opinions purporting to apply the line-of-business test frequently employ a conceptual metaphor of "distance" to characterize the strength of the corporation's proprietary claim over the disputed project. In particular, the determination of whether an opportunity is within a firm's *line of business* turns on the court's perception of the relative distance between the project's requirements on the one hand, and the corporation's expertise on the other. Courts that use this approach view their task as evaluating the relative burdens and difficulties that the firm might have in bridging this specialization gap through adaptation of its managerial strategies, production techniques, capital structure, and the like.[17] Once this distance reaches a critical threshold, the burdens of adaptation are apparently deemed to be so large that the project no longer is in the firm's line of business.

Despite the popularity of this characterization test, its greater generality may well come at the cost of increasing judicial uncertainty. Indeed, opinions applying the test appear to vary substantially in prescribing the precise universe of circumstances in which

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[15] 5 A.2d 503, 514 (Del. 1939).

[16] Chew, for example, finds that as of 1989, *Guth v. Loft, Inc.* was the single most cited case among reported COD decisions. *See* Chew, *supra* note 9. Moreover, a number of prominent states (other than Delaware) currently follow the line-of-business test articulated in *Guth* (either exactly or with a close variant), including California, Connecticut, Illinois, and Ohio. *See, e.g.*, Kelegian v. Mgrdichian, 39 Cal. Rptr. 2d 390, 393-94 (Ct. App. 1995); Katz Corp. v. T.H. Canty & Co., 362 A.2d 975, 979 (Conn. 1975); Levy v. Markal Sales Corp., 643 N.E.2d 1206, 1214-15 (Ill. App. Ct. 1994); Hubbard v. Pape, 203 N.E.2d 365, 368 (Ohio Ct. App. 1964).

[17] *See, e.g.*, Balin v. Amerimar Realty, No. 12896, 1996 Del. Ch. LEXIS 146, at *1 (Nov. 15, 1996); Miller v. Miller, 222 N.W.2d 71 (Minn. 1974); Klinicki v. Lundgren, 695 P.2d 906 (Or. 1985); Imperial Group, Inc. v. Scholnick, 709 S.W. 2d 358 (Tex. Ct. App.—Tyler 1986, writ ref'd n.r.e.). In particular, the fact that a disputed project appears to fall within the "long-range plans" of the corporation may constitute strong evidence that the project is within the firm's line of business.

While the distance metaphor is most applicable to the line-of-business test, a similar conceptual intuition is present in others. *See, e.g.*, Klaus J. Hopt, *Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors' Conflicts of Interest*, *in* CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 299 (Klaus J. Hopt & Gunther Teubner eds., 1985) (describing the lack of clarity in the tests but noting that "[t]hey all try to describe points on a scale between an asset or business which undoubtedly belongs to the corporation . . . and an opportunity or chance which has nothing to do with the corporation and its business" (citation omitted)).

a project falls within the firm's cognizable line of business.[18] For some courts, this domain is surprisingly small, encompassing only those opportunities that either are clearly linked to a corporation's existing operations or would put the fiduciary in direct competition with the firm's current endeavors.[19] Other courts have prescribed a larger domain, measuring relative similarity in terms of potential profitability and whether the pursuit of the opportunity presents a "practical advantage" to the corporation[20] or fits within its prospective plans for expansion.[21] Still others have expanded this domain further still, utilizing a test that ensnares any project that the corporation has the technological and financial *ability* to pursue and develop, apparently without regard to what is economically practical for the firm to undertake.[22] In addition to the case law, the American Law Institute's *Principles of Corporate Governance* utilizes what is essentially an intermediate line-of-business test (albeit one that distinguishes between officers and directors). Section 5.05 proscribes the taking of projects in which a director or senior executive knows or has reason to know that the corporation is interested, *and* all projects that a senior executive has reason to know are closely related to the corporation's current or anticipated future business.[23]

[18] *See id.* at 228 (noting that a court could interpret the line-of-business test very narrowly or very broadly).

[19] *See* Castleman *ex rel.* Thorpe v. CERBCO, Inc., 676 A.2d 436, 443 (Del. 1996) (noting that "[g]enerally, the corporate opportunity doctrine is applied in circumstances where the director and the corporation compete against each other" and that "those transactions which [are] not economically rational alternatives need not be considered by a court evaluating a corporate opportunity scenario"); Johnston v. Greene, 121 A.2d 919 (Del. 1956) (allowing a corporate director to retain patents related to business that was offered to the corporation); *Guth*, 5 A.2d at 513 (stating that "[t]he real issue is whether the opportunity . . . was so closely associated with the existing business activities of [the plaintiff], and so essential thereto, as to bring the transaction within that class of cases [in which appropriation] would throw the corporate officer . . . into competition with his company"); Turner v. American Metal Co., 50 N.Y.S.2d 800 (App. Div. 1944) (holding that a molybdenum mining venture was not sufficiently related to the *ongoing* business of a metal company dealing in copper, lead, zinc, gold, and silver, and the smelting, refining, and marketing of such metals, to constitute a corporate opportunity); Solimine v. Hollander, 16 A.2d 203 (N.J. Ch. 1940) (dismissing a derivative action against directors acting in their individual capacities).

[20] *See, e.g.*, David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Paulman v. Kritzer, 219 N.E.2d 541 (Ill. App. Ct. 1966) (applying Delaware law), *aff'd* 230 N.E.2d 262 (Ill. 1967); Schildberg Rock Prods. v. Brooks, 140 N.W.2d 132 (Iowa 1966).

[21] *See, e.g.*, Central Ry. Signal Co. v. Longden, 194 F.2d 310 (7th Cir. 1952); Rosenblum v. Judson Eng'g Corp., 109 A.2d 558 (N.H. 1954); *Turner*, 50 N.Y.S.2d at 800.

[22] *See, e.g.*, Irving Trust Co. v. Deutsch, 73 F.2d 121, 124 (2d Cir. 1934) (prohibiting fiduciaries from pursuing any opportunities); *Paulman*, 219 N.E.2d at 545 (same).

[23] *See* s*ee also* AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE [hereinafter ALI PCG] § 5.05 (1992). In addition to this "project-based" characterization,

3. *The "Fairness" Test*

Over the last twenty-five years, a small number of jurisdictions have attempted even greater refinements to the doctrine, developing a test of "fairness" to characterize the existence of a corporate opportunity. Under such an approach, an opportunity is deemed to be a corporate one if a fiduciary's appropriation would not satisfy "ethical standards of what is fair and equitable [to the corporation in] particular sets of facts." [24] Much like the line-of-business test, the fairness test may proscribe the appropriation of either existing or prospective activities of the firm. Accordingly, courts employing this approach frequently encounter line-drawing problems when deciding which projects qualify as corporate opportunities.

An even more vexing concern for courts employing a fairness test, however, is the challenge of articulating exactly what "fairness to the corporation" means. Jurisdictions adopting this test have had little success in articulating—beyond recapitulations of the above rhetoric—the substantive contours of a fairness approach. Elaborate attempts to supply them appear to do little more than advocate judicial casuistry and flexibility, [25] often offering digests of guiding principles that essentially replicate other extant characterization tests.[26] Corporations scholars likewise have had difficulties formulating a theory of fairness as a foundational premise for fiduciary duties, leading some scholars to argue (in a more general context) that the very notion of "fairness" has vastly more

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the ALI Principles also take into account (for outside directors) the *source* of the information when it comes to directors. The ALI approach has now been embraced by a few courts, and it is cited favorably by others. *See, e.g.*, Northeast Harbor Golf Club v. Harris, 661 A.2d 1146, 1149 (Me. 1995); Demoulas v. Demoulas Super Mkts., 677 N.E.2d 159, 181 n.36 (Mass. 1997); Derouen v. Murray, 604 So. 2d 1086 (Miss. 1992); Klinicki v. Lundgren, 695 P.2d 906, 917-20 (Or. 1985).

[24] Durfee v. Durfee & Canning, Inc., 80 N.E.2d 522, 529 (Mass. 1948) (citing HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS 204-05 (rev. ed. 1946)).

[25] *See, e.g.*, Annotation, *Fairness to Corporation Where "Corporate Opportunity" Is Allegedly Usurped by Officer or Director*, 17 A.L.R.4th 479 § 2 (1996) (collecting authorities and concluding that "[s]ince the question whether a director or officer has appropriated for himself something that in fairness should belong to his corporation is a factual one to be decided by reasonable inference from objective facts, . . . [t]he result in any particular case has hinged on the surrounding circumstances and particular actions that allegedly constituted a breach of the corporate opportunity doctrine").

[26] Ballantine lists a number of factors implicated by the tests, including whether the opportunity was of special value to the corporation, whether the corporation was actively negotiating for the opportunity, whether the corporation was in a financial position to pursue the opportunity, and whether the fiduciaries would be put in an "adverse and hostile position" to the corporation; whether the fiduciaries received the opportunity because of their corporate positions, whether the fiduciaries were delegated to pursue the opportunity on behalf of the corporation, whether the fiduciaries used corporate resources in identifying or developing the opportunity, and whether the fiduciaries intended to resell the opportunity to the corporation. *See* BALLANTINE, *supra* note 24, at 206.

procedural than substantive significance.[27] These shortcomings have, in part, led commentators and courts to proclaim that the fairness test as applied to the COD merely muddies the waters,[28] adds new layers of confusion to already murky doctrine,[29] and provides no predictable guidelines.[30] Perhaps consequently, the fairness test has held only modest sway among courts.

4. *Alternative and Hybrids*

In addition to the pure approaches described above, many courts over the years have varied, combined, hybridized, and supplemented the traditional tests in an attempt to refine the characterization rules. The amalgam of the line-of-business and the interest-or-expectancy tests seems particularly strong in this regard,[31] but other combinations are possible. Minnesota courts, for instance, conduct a two-step analysis that is effectively a combination of the line-of-business test and the fairness inquiry.[32] Hybrid approaches of this latter sort generally have met with considerable disapprobation, and, in the words of one court, "pile[] the uncertainty and vagueness of the fairness test on top of the weaknesses in the line-of-business test."[33]

Assuming a Corporate Opportunity Exists, what Are the Fiduciary's Obligations?

Should a disputed prospect constitute a corporate opportunity, the fiduciary has essentially two choices: she may either (a) abstain altogether from appropriating it,[34] or

[27] *See* Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 426-29 (1993).

[28] *See* CLARK, *supra* note 4, at 229.

[29] *See* Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1149-50 (Me. 1995); Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 998, 998-99 n.2 (1981).

[30] *See* Chew, *supra* note 9, at 462.

[31] In a recent Delaware Supreme Court opinion, for example, the corporation's "line of business" and its "interest or expectancy" are both named as applicable tests that should be factored into an evaluation of the facts and circumstances of each case. Broz v. Cellular Info. Sys., 673 A.2d 148, 155 (Del. 1996). Interestingly, however, the Delaware court's conception of the interest-or-expectancy test appears to be somewhat broader than its historical predecessors in that it need not involve *current* contractual rights. *See id.* at 156 (stating that "'[f]or the corporation to have an actual or expectant interest in any specific property, there must be some tie between that property and the nature of the corporate business'" (quoting Johnston v. Greene, 121 A.2d 919, 924 (Del. 1956) (alteration in original)).

[32] *See* Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974). Under the *Miller* two-part test, the first step is to determine whether the disputed project is sufficiently related or of special importance to the corporation to justify sanctions against appropriation. If so, then the inquiry proceeds to determine whether the appropriating fiduciary violated the duty of loyalty and fair dealing she owed to the corporation. *See id.*

[33] *Northeast Harbor Golf Club*, 661 A.2d at 1150.

[34] *See* Dunaway v. Parker, 453 S.E.2d 43, 51 (Ga. App. 1994).

(b) promptly disclose the existence and essential terms of the project—along with her personal interest in it—to the corporation, and hope that the corporation rejects it. By effectively requiring disclosure, the doctrine effectively grants the corporation an implied right of first refusal on the project. Accordingly, most jurisdictions specify procedural protocols by which the corporation may reject a disclosed opportunity, thereby empowering the fiduciary once again to pursue it individually.[35]

A theme that permeates the disclosure cases is that only *full* disclosure of all relevant details of the project and the fiduciary's interest enables the corporation to make an informed decision about whether to reject the opportunity.[36] Most cases hold that absent complete disclosure a later rejection is voidable by the corporation or its shareholders.[37] Moreover, in many jurisdictions a failure to disclose important characteristics of the project can also render a number of potential defenses unavailable (see below), and it may even toll the statute of limitations.[38]

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[35] These procedures are usually similar to those necessary to "cleanse" any other interested transaction. *See, e.g.*, ALI PCG § 5.05 cmt. a (1994) (noting that disclosure and rejection doctrine for the COD are similar to those of § 5.02). For a good description of Delaware law on self-dealing transactions under DEL. GEN. CORP. L. § 144, see *In re Wheelabrator Technologies Shareholders Litigation*, 663 A.2d 1194, 1201-03 (Del. Ch. 1995). For California, see CAL. CORP. CODE § 310 (1999).

[36] One court has described the full-disclosure requirement thus:

> [I]f the doctrine of business opportunity is to possess any vitality, the corporation or association must be given the opportunity to decide, upon full disclosure of the pertinent facts, whether it wishes to enter into a business that is reasonably incident to its present or prospective operations. If directors fail to make such a disclosure and to tender the opportunity, the prophylactic purpose of the rule imposing a fiduciary obligation requires that the directors be foreclosed from exploiting that opportunity on their own behalf.

Kerrigan v. Unity Savs. Ass'n, 317 N.E.2d 39, 43-44 (Ill. 1974). Full disclosure plays a central role in the ALI test as well. *See* ALI PCG § 5.05(a) cmt. ("If the opportunity is not offered to the corporation, the director or senior executive will not have satisfied § 5.05(a).").

[37] *See* McCabe Packing Co. v. United States, 809 F. Supp. 614, 617 (C.D. Ill. 1992) ("Under Illinois law, the business decision of a corporation not to engage in a particular line of business is beyond any questioning by the courts, as long as the corporation was given the opportunity upon full disclosure of the facts to decide whether to enter the particular line of business."); Havlicek/Fleisher Enters. v. Bridgeman, 788 F. Supp. 389, 395 (E.D. Wis. 1992) ("Without full disclosure, an informed acceptance or rejection of a corporate opportunity cannot be made."); Castleman *ex rel.* Thorpe v. CERBCO, Inc., 676 A.2d 436, 437 (Del. 1996).

[38] *See* 3 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 861.1, at 285 (perm. ed. rev. vol. 1994) ("[M]ere disclosure of the transaction, without revealing the surrounding circumstances, is not sufficient, and failure to make complete disclosure constitutes constructive fraud, thereby tolling the statute of limitations.").

Once a Fiduciary Discloses, What Must/May the Corporation Do?

Importantly, full disclosure to the corporation does not, *ipso facto*, entitle the fiduciary to pursue a business prospect personally. Much to the contrary, the fiduciary must still wait for the corporation to "reject" the opportunity. The process of rejection typically follows a procedure similar to that in more generic conflict-of-interest contexts, such as (1) approval or ratification by either an affirmative vote of the disinterested directors, (2) approval or ratification by the disinterested shareholders,[39] or (3) in the case of a senior executive, approval by a disinterested superior.[40] While formalized acts of rejection (such as a formal vote of disinterested directors) have been held to be a type of "safe harbor," even in their absence a disclosing fiduciary may still be able to demonstrate rejection by demonstrating that the corporation informally rejected the opportunity[41] or that appropriating the opportunity was nonetheless "fair" to the corporation.[42]

If Liability is Found, What Is/Are the Applicable Remedies?

The remedy for appropriation of a business opportunity can be either legal or equitable, depending on the case, though the general preference appears to be the latter. Consequently, unlike other commercial settings, the monetary remedy in most corporate opportunity cases tend to be gains-based rather than harm-based in nature.[43] In fact, the presumptive remedy for such a breach is the imposition of a constructive trust on the disputed enterprise, effectively disgorging all of the fiduciary's verifiable profits (even if they exceed the corporation's provable loss, and even if there is *no* provable loss[44]). It is

[39] ALI PCG § 5.02(a)(2)(d).

[40] *See* Del. Gen. Corp. L. § 144(1); ALI PCG § 5.05(a)(3)(B) (taking a corporate opportunity is acceptable if the disinterested directors reject the opportunity "in a manner that satisfies the standards of the business judgment rule").

[41] Broz v. Cellular Information Systems, 673 A.2d 148 (Del. 1996), *rev'g* 663 A.2d 1180 (Del. Ch. 1995).

[42] *See* ALI PCG § 5.05(c) cmt.

[43] *See* Milbank, Tweed, Hadley & McCloy v. Boon, 13 F.3d 537, 543 (2d Cir. 1994) ("[B]reaches of a fiduciary relationship in any context comprise a special breed of cases that often loosen normally stringent requirements of causation and damages."); *see, e.g.*, Thorpe v. CERBCO, Inc., 676 A.2d 436, 445 (Del. 1996) ("Once disloyalty has been established, [Delaware law] require[s] that a fiduciary not profit personally from his conduct, and that the beneficiary not be harmed by such conduct."); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.").

[44] *See* 76 AM. JUR. 2D, *Trusts* § 232 (1992); 18B AM. JUR. 2D, *Corporations* § 1772 (1985) (noting that liability can obtain even if the corporation *benefited* from the fiduciary's appropriation).

nevertheless common for courts to reserve some portion of the profits for the breaching fiduciary, as compensation for services rendered in overseeing the disputed opportunity.[45]

In cases where the appropriation is deemed to be particularly malicious, oppressive, or in bad faith, punitive damages may be available as well. But beyond this distinction, most courts appear to inquire very little about the *path* the fiduciary followed in breaching her duty. In terms of Figure 1, a fiduciary might have breached by completely failing to disclose (node X_1) or by disclosing but failing to secure proper rejection before pursuing the project (node X_2). Regardless of this path, most courts tend to impose a constructive trust on a breaching fiduciary as a default measure of damages. The likelihood of punitive damages, however, appears to be greater for appropriation following nondisclosure than it is for appropriation following full disclosure but absent refusal by the firm.[46]

Are there Any Defenses?

Over the years, courts have crafted a few important affirmative defenses to a COD action. Three of the most salient are the so-called "source" rule, the "incapacity" defense, and the doctrine of "implied refusal." The first two of these defenses have the effect of neutralizing the determination that a disputed project was a corporate opportunity to begin with. The final defense has the effect of substituting for an express rejection of the opportunity by the corporation.

1. The "Source" Rule

A number of jurisdictions permit a limited defense to a fiduciary who can demonstrate that a proffered business opportunity came from a source that was attracted to her *personal* skill, reputation and expertise, and not those of the corporation. The ALI Principles, for example, which adopt just such an approach alongside the line-of-business test, state that a corporate opportunity constitutes any new business prospect that a director: (1) learns of in her corporate capacity; (2) has reason to know is being offered to the corporation; or (3) acquires through the use of corporate information or property, if the fiduciary has reason to know that the corporation would be interested in the prospect.[47] Notably omitted from this definition is that class of business prospects that are offered to the fiduciary in her personal capacity, and not acquired through use of corporate assets or information – a category that fiduciaries have sometimes been able to exploit in their own defense.[48] Nonetheless, while this source-based approach can be seen to play a role in a number of decisions, numerous commentators have leveled significant

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[45] *See, e.g.*, Energy Resources Corp. v. Porter, 438 N.E.2d 391, 394 (Mass. App. Ct. 1982).

[46] *See, e.g.*, United Teachers Assocs. Ins. Co. v. MacKeen & Bailey, Inc., 847 F. Supp. 521, 543-44 (W.D. Tex. 1994); Levy v. Markal Sales Corp., 643 N.E.2d 1206, 1221-23 (Ill. App. Ct. 1994). Moreover, the route increasingly appears to matter in the availability of the incapacity defense (see below).

[47] *See* ALI PCG § 5.05(b).

[48] *See* Central Ry. Signal Co. v. Longden, 194 F.2d 310, 319 (7th Cir. 1952); Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939).

criticism at it, citing the virtual impossibility of decoupling the relative contributions of the fiduciary's private attributes as opposed to her corporate affiliation in attracting the project.[49] It has therefore proven to be of somewhat tenuous utility to defendants.

2. The "Incapacity" Defense

On a somewhat more promising front (at least for defendants), a number of jurisdictions – particularly those following the line of business test – have also embraced its negative corollary, affording an affirmative defense to an appropriating fiduciary who can argue convincingly that the corporation was somehow unable to pursue the opportunity itself.[50] While the "incapacity" defense can take a number of different forms, three are most prevalent. In one strand of cases, fiduciaries have argued that the corporation was *legally* unable to pursue the opportunity (e.g., due to ultra vires concerns, existing negative injunctions, or prospective antitrust problems[51]). In another, the fiduciaries' defense centers on the corporation's *financial* inability to exploit the business prospect (due to liquidity constraints, bankruptcy, and the like[52]). In a third strand of cases, defendants have asserted that corporate incapacity stemmed from more *generic business constraints*, such as a lack of appropriate personnel, lack of profitability, or refusals by third parties to deal with the corporation, that rendered the project de facto unavailable to the firm.[53]

On the whole, claims of legal and financial incapacity have proven significantly more effective for defendants than those claiming generic business constraints. In particular, alleged "refusals to deal" by the third party have been scrutinized most heavily in practice. Particularly troubling to courts in such cases is the problem of verifying in

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[49] *See, e.g.*, CLARK, *supra* note 4, at 230 ("The distinction between official and individual capacities can create endless argument about the proper characterization of facts. . . . [I]t is often difficult to decide when an executive has stepped completely outside of his role."); *see also* David Clayton Carrad, *The Corporate Opportunity Doctrine in Delaware: A Guide to Corporate Planning and Anticipatory Defensive Measures*, 2 DEL. J. CORP. L. 1, 2 (1977) (noting the difficulty of clearly demarcating the fiduciary's role).

[50] *See, e.g.*, Castleman *ex rel*. Thorpe v. CERBCO, Inc., 676 A.2d 436, 443 (Del. 1996) ("[T]hose transactions which were not economically rational alternatives [for the corporation to pursue] need not be considered by a court evaluating a corporate opportunity scenario.").

[51] *See Borden*, 530 F.2d at 493; Alexander & Alexander v. Fritzen, 542 N.Y.S.2d 530, 535 (App. Div. 1989); *Urban J. Alexander Co.*, 224 S.W.2d at 928. Despite the sporadic success of such arguments, courts are increasingly limiting the incapacity defense only to cases where the fiduciary fully discloses but does not receive proper rejection before appropriating. *See, e.g.*, *Demoulas*, 677 N.E.2d at 181.

[52] *See* Borden v. Sinskey, 530 F.2d 478, 493 (3d Cir. 1976); *Thorpe*, 676 A.2d at 443; Broz v. Cellular Info. Sys., 673 A.2d 148, 155 (Del. 1996); *Northeast Harbor Golf Club*, 661 A.2d at 1149; Urban J. Alexander Co. v. Trinkle, 224 S.W.2d 923, 928 (Ky. 1949).

[53] *See* Energy Resources Corp. v. Porter, 438 N.E.2d 391, 394 (Mass. App. Ct. 1982).

hindsight the third party's resolve, especially in light of the obvious incentives for both the fiduciary and the third party to make self-serving claims that such barriers were prohibitive. As such, courts are virtually unanimous in restricting the refusal-to-deal defense to those situations where the fiduciary has fully disclosed, so as to "test" the nature of the incompatibility between the third party and the corporation.[54]

3. Implied Rejection

An interesting special case for the COD involves situations where the fiduciary has disclosed the opportunity, but the corporation fails to act. A few jurisdictions have developed what amounts to a doctrine of "implied refusal" for such situations, allowing the fiduciary to pursue the opportunity if the corporation does not act upon it within a reasonable time following disclosure. Defendants generally have been successful in such cases only when they argued that they acted in good faith by fully disclosing and did not use other corporate assets in pursuing the opportunity.[55] Once again, however, there is a veritable dearth of case law that deals squarely with the (so-called) implied rejection doctrine, and its general viability remains both uncertain and disputed.[56]

Is it possible to "contract out" of the doctrine?

Because the COD is a subspecies of the fiduciary duty of loyalty, it is historically treated as an equitable doctrine. Perhaps accordingly, some courts have expressed skepticism of private attempts to alter or limit such duties contractually. Indeed, notwithstanding the fact that most states now have exoneration statutes that permit

[54] *See, e.g.*, Regal-Beloit Corp. v. Drecoll, 955 F. Supp. 849, 863 (N.D. Ill. 1996) (noting that in the absence of disclosure, it is impossible to test a fiduciary's assertion that a corporation could not pursue an opportunity because of a third party's refusal to deal); *Energy Resources Corp.*, 438 N.E.2d at 394 (rejecting a refusal to deal defense and stating that "[w]ithout full disclosure, it is too difficult to verify the unwillingness to deal and too easy for the executive to induce the unwillingness"); Production Finishing Corp. v. Shields, 405 N.W.2d 171 (Mich. Ct. App. 1986); Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358 (Tex. Ct. App.—Tyler 1986, writ ref'd n.r.e.). In fact, in some jurisdictions courts have been sufficiently troubled by verifiability problems to disallow the incapacity defense *altogether*, effectively requiring the insider to tender any opportunity about which she learns as a result of her affiliation with the corporation. *See, e.g.*, Irving Trust Co. v. Deutsch, 73 F.2d 121 (2d Cir. 1934); Kerrigan v. Unity Sav. Ass'n, 317 N.E.2d 39 (Ill. 1974).

[55] *See, e.g.*, Lussier v. Mau-Van Dev., 667 P.2d 804 (Haw. Ct. App. 1983); Litwin v. Allen, 25 N.Y.S.2d 667 (Sup. Ct. 1940); Farber v. Servan Land Co., 662 F.2d 371 (Former 5th Cir. 1981); CST, Inc. v. Mark, 520 A.2d 469 (Pa. Super. Ct. 1987).

[56] *Compare* ALI PCG §5.05(a) cmt. (requiring that the corporation "promptly" accept or reject the opportunity once it has been disclosed and offered, and that failure to accept the opportunity within a reasonable time will amount to a rejection of the opportunity), *with* 18B AM. JUR. 2D *Corporations* § 1788 (1985) (stating that "[t]he corporation's unwillingness to take advantage of the opportunity in question must be *clearly manifested*" (emphasis added)).

corporations to limit or eliminate liability for breaching fiduciary duties through their charters, these same statutes also expressly exclude the fiduciary duty of loyalty from their application.[57] As such, the practice of weakening the reach of the COD through contracts, bylaws, or charter provisions has often been thought suspect by both courts and commentators.[58] On the other hand, it is difficult to ignore the fact that in most jurisdictions, the very definition of a "corporate opportunity" (see above) turns on the current and prospective interests and expectancies of the corporation – factors which depend in part on the firm's contractual dealings and corporate governance structure.[59] As such, the legitimacy of express efforts to limit the application of the COD has remained extremely uncertain.

Delaware has recently attempted to address this uncertainty by amending the Delaware General Corporation Law. Along with other, unrelated amendments,[60] the General Assembly added an additional paragraph to Section 122, which now reads (in relevant part):

§ 122. Specific Powers

> Every Corporation created under this chapter shall have power to –
> . . .
> (17) Renounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or one or more of its officers, directors or stockholders.

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[57] *See* DEL. CODE ANN. tit. viii, § 102(b)(7) (1996). A majority of other states have similar limitations, including California, CAL. CORP. CODE § 204(a)(10)(iii) (West 1990).

[58] *See, e.g.,* Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 743 (1992) (opining that the COD may be a type of "one-way" default rule, permitting parties to enhance the fiduciary's minimal duties, but not to weaken them.); Siegman v. Tri-Star Pictures, Inc, 15 Del. J. Corp. L. 218, 238 (Del. Ch. 1989) (finding that a charter amendment limiting the reach of the COD would "arguably operate to eliminate or limit the directors' liability for breach of their duty of loyalty").

[59] Indeed, there is some authority to support the proposition that parties have some limited ability to modify the COD contractually, *not* by limiting damages, but instead by crafting an express definition of a "corporate opportunity." *See, e.g.,* American Inv. Co. v. Lichtenstein, 134 F. Supp. 857 (E.D. Mo. 1955) (permitting a corporation to adopt a policy excluding a certain activity from the operation of the COD); *see also* ALI PCG § 5.05(a) (allowing certain opportunities to be rejected in advance by the corporation).

[60] For an overview of the all the recent amendments, see Lewis S. Black and Fredrick H. Alexander, *Analysis of the 2000 Amendments to the Delaware General Corporation Law* (Aspen Law & Business, 2000).

This amendment is the first of its kind in the United States, and it has potentially far-reaching implications.[61] Most importantly, this amendment apparently resolves the uncertainty surrounding the advance renunciation of the COD in favor of general permissiveness and contractual flexibility. It does so, however, in a manner that carries at least three important caveats that counsel should keep in mind.

First, the amendment emphasizes that any advanced renunciation of the doctrine must be related to *specified* opportunities, or classes/categories thereof. As such, the statute does not appear to permit sweeping renunciations that apply to all opportunities, classes and categories *writ large*, but instead appears to be limited to specific "carve outs" through express action of the corporation. Given the common-law history of the COD, it is reasonable to expect that courts will tend to construe such carve outs narrowly, resolving ambiguities in favor of the corporation.

Second, while the statute allows for renunciation of opportunities through the corporate charter, it also permits renunciation "by action of [the] board of directors." Such action could conceivably include a by-law amendment (if feasible by action of the board), or even the holding of a less formalized vote among the directors or authorized subcommittee thereof. Nevertheless, the legislative history and synopsis of the amendment clearly reflects the Assembly's view that the board must comply with its fiduciary duties when acting to renounce corporate opportunities. This caveat suggests that it would probably be most prudent for Delaware corporations to renounce opportunities before a conflict arises, preferably at the time of formation if feasible.[62]

Finally, while the amended Section 122 permits corporations to alter the definitional categories that give rise to *liability*, the text of the section does not directly bear on contractual modifications of the *remedy* resulting from misappropriation of corporate opportunities (however defined). Here, it is likely that courts will continue to use their discretion to fashion their own remedies for breach, as discussed above.

[61] Although the amendment does not radically and unambiguously alter existing doctrine considerably, it goes a long way in clarifying whether the COD is a default or immutable rule.

[62] This point is particularly salient in the context of a parent who sells off a portion of its subsidiary in order to raise capital. By placing an express renunciation in the subsidiary's charter, the parent can avoid an inevitable conflict of interest that would occur should it attempt to cause the subsidiary to renounce an opportunity after selling off the minority stake.

Relevant Case Law

Below are synopses of numerous important and/or recent cases dealing with the COD. The cases are categorized into three categories: "Delaware Cases," "California Cases," and "Other." Be advised that this list is far from exhaustive, and should therefore not be treated as a complete canvassing of recent doctrine.

Delaware Cases:

Broz v. Cellular Info. Sys., 673 A.2d 148 (Del. 1996)

A public cellular communications firm (CIS) brought a corporate opportunity claim against its former outside director (Broz) and his wholly-owned corporation (RFBC). Broz, president and sole stockholder of RFBC was also an outside director of CIS. Broz sought to purchase a federal cellular license (the "Michigan 2" license) from Mackinac, a third party. In 1992, CIS filed for Chapter 11 reorganization, and as part of the restructuring, agreed to restructure its existing loan obligations, which inhibited its ability to incur new debt or undertake new acquisitions. Mackinac began soliciting bids for Michigan 2 in June of 1994, and Broz informally approached several fiduciaries of CIS between June and September of 1994 expressing his interest in purchasing Michigan 2 on behalf of RFBC. However, also in June of 1994, PriCellular, yet another cellular provider, began negotiations to acquire CIS and made a tender offer in August 1994, but due to financial difficulties was initially unable to complete the deal. PriCellular was also interested in purchasing Michigan 2 from Mackinac, and purchased an option in September of 1994, but the option was not transferable and the agreement left the option open for any higher bidder. On November 14, 1994, Broz (acting on behalf of RFBC) tendered a successful offer to Mackinac only nine days prior to the closing of the PriCellular tender offer with CIS.

The Court of Chancery found that Broz did not misuse proprietary information that came to him in a corporate capacity, nor did Mackinac consider CIS a viable candidate for the acquisition of Michigan 2. Nevertheless, the Court held for CIS based on two considerations. First, it held that although Broz discussed his information casually with other fiduciaries of CIS, he never formally presented the opportunity to the Board to obtain a "valid" rejection. Second, it held that although CIS was not able to pursue Michigan 2 its existing post-reorganization state, Broz should have considered the prospective interest PriCellular would have in the license after finalizing its acquisition of CIS. On appeal, the Supreme Court of Delaware reversed. Chief Justice Veasey's opinion held that formal presentation of the opportunity to the Board was not necessary. The Court also held that the corporate opportunity doctrine should not apply, because CIS was not financially capable of exploiting the Michigan 2 opportunity, and Broz was not obligated to consider the contingency of a PriCellular acquisition of CIS.

Thorpe v. CERBCO, Inc., 676 A.2d 436 (Del. 1996)

A shareholder ("Thorpe") brought suit against CERBCO, a holding company with voting control of three subsidiaries, and its controlling shareholders who were also officers and directors ("the Eriksons"), for breach of their duty of loyalty based on usurpation of a corporate opportunity. Explicitly, a third party expressed interest in purchasing CERBCO's most profitable subsidiary (of which the plaintiff owned shares), but the Eriksons instead negotiated a sale of their ownership of controlling stock in CERBCO for a significant premium. Thorpe made a demand on the CERBCO board that the proposed transaction be rejected or that the Eriksons provide an accounting for the control premium associated with their sale of stock. The board considered an alternative transaction, but the Eriksons objected to the proposal because it would destroy the control premium of their stock. Ultimately, the stock purchase was never completed, due to a breakdown in negotiations with the third party.

The Chancery Court held that the Eriksons breached their duty of loyalty, by failing to make complete disclosure of the corporate opportunity and by not removing themselves from the matter as interested parties. However, the Chancellor held that the Eriksons had power as controlling shareholders, under 8 *Del. C.* §271, to veto any transaction that would have constituted a sale of all or substantially all of CERBCO's assets. Therefore, the Chancellor found that the Eriksons' conduct created no cognizable injury to the corporation. The Supreme Court affirmed in part and reversed in part, agreeing that the Eriksons had breached their duty of loyalty. Rather than the "entire fairness" standard the Chancellor used to review the transaction, the Court applied the corporate opportunity doctrine and concluded that although the corporation had an interest in the opportunity, the Eriksons' ability as shareholders to exercise their §271 rights made any other alternative transactions unavailable to CERBCO. The Court reversed the Chancellor, because it found that some recovery was warranted for the breach and remanded for determination of damages stemming from the Eriksons' use of corporate funds in their negotiation and preparation for the sale of stock.

Benerofe v. Cha, 1998 Del. Ch. LEXIS 28

Shareholders sued Inorganic Coatings, Inc. ("ICI") and its board of directors for actions related to a Stock Purchase Agreement ICI negotiated with Kun Sul Painting Industries Co., Ltd. ("KSP") in 1994. Plaintiffs alleged that KSP designees dominated ICI's board, with one defendant holding the position of president and chief executive officer of ICI. Plaintiffs also alleged that KSP was allowed to purchase ICI products at prices that were significantly lower than those it could obtain in the open market.

The Court found that plaintiffs failed to meet their burden of proving defendant usurped a corporate opportunity, because plaintiffs failed to allege that ICI is able to exploit the opportunity at issue. The Court stated that plaintiffs failed to allege that ICI would have been able to sell products in the Korean market without the assistance of KSP. Further, the Court concluded that plaintiffs' showing that ISI had contracts with distributors in Korea prior to ISI's agreement with KSP was not enough to prove that ISI had the ability to utilize the opportunity without the assistance of KSP.

In re Digex, Inc. Shareholders Litig., 2000 Del. Ch. LEXIS 171 (2000)

Shareholders for the plaintiff Digex Inc. ("Digex") brought this derivative action against defendant and parent company, Intermedia Communications, Inc. ("Intermedia"), for usurping a corporate opportunity in an acquisition transaction. Intermedia, the majority shareholder of Digex, was in financial distress. It had several options but chose initially to sell Digex to third party bidders. After WorldCom had emerged as the most likely purchaser of Digex, Intermedia directors convinced WorldCom to purchase Intermedia itself. In addition, before the merger was accepted, the interested directors on the Digex board caused Digex to waive the application of Del. Gen. Corp. L. § 203, thereby enabling WorldCom to freeze out minority Digex shareholders with three years of its Intermedia acquisition. The minority shareholder plaintiffs moved for a preliminary injunction barring the merger and barring the effectiveness of the § 203 waiver.

In denying this motion, the Chancery Court held that the plaintiffs' corporate opportunity claims were unlikely to succeed on the merits. In particular, it held, the acquisition transaction was never an interest or expectancy of Digex, given that Intermedia (as the dominant shareholder) could always veto a sale of the company to an outside buyer. Partially distinguishing *Thorpe v. CERBCO* (see above), the Court held that because Digex was fully informed of Intermedia's interest and the terms of its private arrangement with WorldCom, the defendant here did not breach its duty of loyalty in negotiating the deal with WorldCom. Moreover, while the Court also refused preliminary relief on the § 203 claim for lack of a showing of irreparable harm, it held nonetheless that the plaintiffs' likelihood of prevailing on this claim was high, representing a significant constraint should WorldCom attempt to exploit the waiver.

International Equity Capital Growth Fund v. Glegg, 1997 WL 208955 (Del. Ch.)

A 26.2% shareholder in a close corporation challenged a series of transactions between a corporation ("Globe"), its 80%-owned subsidiary ("Diamond"), and two directors of both corporations. In May of 1994, the Diamond board allegedly agreed to prohibit any officer from investing in a competitor of Diamond, yet in 1995 Clegg acquired a competitor, The Handy Craftsman, Inc. ("Handy Craftsman"). Furthermore, director/defendant Clegg acting on behalf of Diamond contracted to acquire all or substantially all of the assets of Handy Craftsman for $2 million dollars in 1996. The plaintiff alleged Clegg usurped a corporate opportunity in buying Handy Craftsman in violation of a board decision.

The Court concluded (inter alia) that while the alleged usurpation of a corporation opportunity had been completed, the purchase agreement between Diamond and Handy Craftsman as described in the plaintiff's pleadings did not constitute a claim ripe for judicial review. The Court stated that since mere agreements to agree are unenforceable at common law, Diamond had taken no action it could review in connection with its announced intention to acquire Handy Craftsman. The Court therefore dismissed the claims without prejudice.

Kahn v. Icahn, 1998 Del. Ch. LEXIS 223

Shareholders of American Real Estate Partners, L.P. ("AREP") brought suit against AREP's general partner, American Property Investors, Inc. ("API"), API's sole shareholder and chief executive officer, Carl C. Icahn ("Icahn"), and another corporation associated with Icahn. Plaintiffs alleged that Icahn breached his fiduciary duties to AREP and usurped corporate opportunities capitalizing on investment opportunities through entities other than AREP, thereby denying AREP of the benefit of full ownership interests in the businesses. Icahn asserted that the partnership agreement expressly allowed direct or indirect competition with the business of the partnership.

The Court granted defendants' motion to dismiss. In particular, it speculated that the flexibility to expand or restrict fiduciary duties of limited partnerships often leads parties to choose limited partnership form in Delaware. Ultimately, the court concluded that the grant of authority to compete in the partnership agreement constitutes constructive notice to plaintiffs defeating any "expectancy" in the corporate opportunity. Moreover, the court stated that plaintiffs' knowledge of and involvement in the challenged transactions jointly imply that AREP was not entirely precluded from participating in the opportunities.

Kohls v. Duthie, 2000 Del. Ch. LEXIS 103

Shareholders brought an action against Kenetech Corp. ("Kenetech") and members of its board of directors stemming from the purchase of a large block of shares from a majority shareholder at a discounted price. Plaintiffs alleged that the large shareholder informed the president and chief executive officer of Kenetech, defendant Lerdal, of its interest in selling its shares, 30% of the common stock, for a nominal price in 1997. Plaintiffs argued that the board of directors failed to formally meet and discuss whether the corporation would be interested in repurchasing the shares, but instead the president purchased the shares individually for $1,000, which were valued at over $8.2 million at time of trial. Defendants claimed that § 160(a)(1) of the Delaware General Corporation Law prohibited Kenetech from repurchasing shares at a time when its capital is impaired, and that restrictive covenants in Kenetech's senior notes and certain protective provisions of Kenetech's charter prohibited the transaction. However, plaintiffs alleged that defendants breached their fiduciary duties by not soliciting expert opinions regarding the potential negative consequences of a stock repurchase.

The Court rejected defendants' claims that the corporate opportunity was unavailable to Kenetech, because its capital was impaired or due to the restrictions in the debt instruments. The Court also rejected defendants' argument that Kenetech had no expectancy in the opportunity, stating that regardless of whether or not Kenetech had a stock repurchase program, the opportunity at issue was too lucrative for the corporation not to consider. Further, the Court held, the small purchase price of the shares would not pose a significant problem for Kenetech under section 160 of the Delaware code. Also, the Court distinguished *Broz*, where the Delaware Supreme Court emphasized the financial incapacity of the corporation as one factor in determining whether a corporate opportunity has been usurped. In this case, the restrictive covenants in the senior notes did not make the opportunity impossible, because the debt holders would benefit from the repurchase due to the reduction of outstanding common shares.

Odyssey Partners, L.P. v. Fleming Co., Inc., 735 A.2d 386 (Del. Ch. 1999), 1999 Del Ch. LEXIS 88

Shareholders alleged that defendant corporation improperly used its control as majority stockholder of one of its subsidiaries to the detriment of the subsidiary. Plaintiffs argued that defendant's employees who were also members of the board of directors of the subsidiary did not demonstrate independent business judgment. Further, plaintiffs alleged that defendant engaged in unfair competition and breached its duty to the subsidiary and its shareholders in its purchase of all or substantially all of the subsidiary's assets at a foreclosure sale.

The Court found that plaintiffs failed to state a claim upon which relief could be granted. The Court held that plaintiffs failed to establish that defendant dominated the board of its subsidiary, that its employees breached their fiduciary duties, or that it used its control as a majority stockholder to restrict the ability of the subsidiary to restructure its debt. Addressing defendant's acquisition of the subsidiary's debt at the foreclosure sale, the Court cited *Balin v. Amerimar Realty Co.*, 1996 Del. Ch. LEXIS 146 for the proposition that a necessary element of corporate opportunity doctrine is that the company be financially able to exploit the opportunity. Further, the Court stated that due to the fact that the subsidiary was insolvent and lacked the capacity to purchase the debt at issue, defendant was not required to first present the opportunity to the subsidiary before acquiring the debt itself.

California Cases

BT-I v. Equitable Life Assurance Society of the U.S., 75 Cal. App. 4th 1406, 89 Cal. Rptr. 2d 811 (Cal. Ct. App. 1999)

BT-I, a limited partner, brought an action against The Equitable Life Assurance Society of the United States ("Equitable"), the general partner, based on the latter's foreclosure on a deed of trust on the limited partnership's sole asset, an office building. In 1985, BT-I entered into a general partnership with Equitable, to develop and operate a commercial office building and retail complex in Orange County, which was transferred into a limited partnership in 1991. Equitable had a 70 percent interest and BT-I had a 30 percent interest. The partnership agreement gave Equitable wide latitude to refinance and restructure the partnership debt and manage and control the partnership and its assets. BT-I alleged that Equitable maneuvered to oust it and secretly negotiated with the creditor of the partnership to purchase loans at a steep discount. When the loans became due, Equitable refused to provide partnership information frustrating BT-I's efforts to seek other financing and Equitable foreclosed and purchased the building at the sale.

The Appellate Court reversed the trial court's decision sustaining Equitable's demurrer without leave to amend, finding that the limited partnership agreement could not relieve Equitable of its fiduciary duty not to engage in self-dealing and to provide complete disclosure. The Appellate Court held that Equitable's conduct in buying and foreclosing the loans went far beyond whatever safe harbor might be found in the partnership agreement. The court stated that offering the partnership the opportunity to purchase the loan was not enough to avoid liability under the corporate opportunity doctrine, because to do so would allow Equitable to abrogate its fiduciary duty not to purchase and foreclose partnership debt.

Robinson, Leatham & Nelson, Inc. v. Nelson, 109 F.3d 1388 (9th Cir. 1997)

Robinson, Leatham & Nelson, Inc. ("RLN") was formed when Nelson joined a company called RLC in 1988, which was a real estate investment company founded by

Leatham and Robinson. Nelson became a director and 27% shareholder. In 1989, RLN began negotiations with Winthrop Financial Associates ("WFA"), a partnership to which Nelson belonged prior to joining RLN, to collaborate in the restructuring of four Net Lease partnerships ("NLPs"). WFA eventually sued RLN, together with Robinson, Leatham and Nelson individually, eventually settling with Nelson. Nelson's relationship with Leatham and Robinson deteriorated in 1989 and this claim was brought before the district court in 1990. RLN alleged that Nelson violated his duty to RLN and deprived it of the fees it had expected to earn in restructuring NLPs and left it unable to pursue its claims against WFA, due in part to his personal settlement agreement.

The Ninth Circuit affirmed the decision of the Court of Appeals finding that: (1) Nelson did not breach his fiduciary duties by resigning and going to work for an entity that had a contract with RLN, in light of Nelson's prior association with the entity; and (2) Nelson did not usurp any corporate opportunity. The Court found that RLN had failed to show it had a corporate opportunity to proceed with the restructuring activities undertaken by WFA. In particular, it concluded that Nelson only benefited from the alleged transaction due to ownership interests in the respective companies that existed prior to his fiduciary relationship with RLN. Further, the Court held that RLN had not shown it had a reasonable expectancy to do the restructurings or that it had the financial resources to take advantage of the opportunities, because its agreement with WFA had expired. The Court concluded that Nelson did not become privy to the transaction with WFA through his position with RLN and he did not use a trust opportunity for personal advantage.

U.S. v. Rodrigues, 229 F.3d 842 (9th Cir. 2000)

Defendant Jess A. Rodrigues, former owner and Chairman of the Board of Saratoga Savings and Loan in California, was convicted of ten counts arising from his participation in four real estate transactions with Saratoga between 1984 to 1988. The district court applied the Victim and Witness Protection Act ("VWPA"), *18 U.S.C.§§3663, 3664*, and ordered Rodrigues to pay restitution to compensate Saratoga for the usurped corporation opportunities due to Rodrigues' substitution of himself for Saratoga in the four real estate transactions. Although the loans extended by Saratoga were repaid with appropriate interest, the government argued that having lost the opportunity to participate in the deals as an equity partner damaged Saratoga.

The Ninth Circuit reversed and remanded. Addressing the issue not answered by its recent decision in *United States v. Stoddard*, 150 F.3d 1140, 1147 (9th Cir. 1998), the court considered whether restitution of profits from lost corporate opportunities was authorized by the VWPA. Discussing the corporate opportunity doctrine, the court stated that most courts limit the doctrine to business opportunities in which the corporate has at least a tangible expectancy. Further, the court found that although corporate opportunity doctrine allows recovery for a variety of interests, including mere expectancies, restitution under the VWPA is confined to direct losses. Saratoga suffered a contingent loss due to its expectancy interest in the projects, but an expectancy interest is not vested for the purposes of the VWPA. The Ninth Circuit remanded for consideration of tangible damages suffered by Saratoga due to Rodrigues' usurpation of vested contractual interests in certain property.

MacIsaac v. Pozzo, 81 Cal. App. 2d 278, 183 P.2d 910 (Cal. Ct. App. 1947)

This was an appeal from Superior Court regarding an action by Donald MacIsaac ("MacIsaac") and Arthur F. Menke ("Menke"), copartners doing business as MacIsaac & Menke Company, against Emile A. Pozzo ("Pozzo") and Louis J. Pozzo, copartners doing business as Pozzo & Pozzo, for declaratory relief concerning the division of fees stemming from a joint venture agreement for a construction project in Utah. In 1942, the parties entered into a joint venture agreement that created an organization in Utah under the name of MacIsaac, Menke and Pozzo ("the Utah firm"). Their agreement related solely to one contract and the parties were to share equally the gains and losses, but the joint venture agreement contained provisions regarding additional jobs. Plaintiff brought this action for declaratory relief based on a contract for an additional project, whereby plaintiff and defendant had 85% and 15% shares respectively, contending that the fee should be divided pursuant to the contract terms. Defendant answered and filed a cross-complaint alleging its consent to the 85-15% division had been procured by fraud, thereby entitling defendant to 50% of the fee. The court concluded that in negotiations for the project, it was represented that the Utah firm would perform the work and certain employees testified that they believed they were working for the Utah firm. The court found that the contract was negotiated on behalf of the Utah firm, and defendant suffered damage for the balance of one-half of the net profit from the project.

The court of appeal found that Menke was a fiduciary as to all matters pertaining to the joint venture. Further, the court found that plaintiff attained the contract for the Utah firm based its reputation, organization and credit. The contract was nullified, because Pozzo's consent was induced by the fraud of Menke due to the misrepresentation of facts to Pozzo, it was not voluntary and the court concluded it provided grounds for relief. Finding the parameters of the joint venture agreement included new business opportunities, the court stated that the primary duty of the parties was to take no advantage of each other within their fiduciary relationship by means of the slightest concealment, misrepresentation or adverse pressure. Therefore, defendant was entitled to full disclosure as to the negotiations that led to the contract and plaintiff contrived to appropriate an opportunity that belonged to the Utah firm. The court affirmed the lower court's decision awarding defendant equal division of the net profits of the contract.

New v. New, 148 Cal. App. 2d 372, 306 P.2d 987 (Cal. Ct. App. 1957)

Plaintiff appealed from a judgment that rejected her claim that defendant, her former husband, wrongfully appropriated a corporate opportunity that belonged to two corporations in which he held stock. The divorce decree awarded plaintiff with certificates of participation in the net proceeds of certain oil properties operated by two corporations, but defendant was awarded shares of stock in both corporations as separate property. Defendant and his business associate negotiated a new lease on an oil producing property for a corporation organized and wholly owned by themselves, because the chairman of the Los Angeles Court Board of Supervisors informed then that the two corporations in which defendant owned stock were ineligible for the project. The trial court concluded that there was no corporate opportunity for defendant to misappropriate and that defendant did not stand in a fiduciary relationship with plaintiff and owed her personally no duty to refrain from appropriating that opportunity if one did exist.

The court of appeal affirmed the lower court's judgment. Reiterating the corporate opportunity doctrine stated in *Industrial Indem. Co. v. Golden State Co.*, 117 Cal. App. 2d 519, 533, the court stated that a corporate officer or director may not seize for himself to the detriment of his company business opportunities in the company's line of activities which the company has an interest and prior claim to obtain. The court also stated that the determination of the particular factual circumstances under which a fiduciary takes business opportunities for himself and the application of the ethical standards of fairness and good faith required from a fiduciary to said set of facts is mainly for the trier of facts. The court found that the two corporations were restricted from additional drilling activities integral to the opportunity at issue, due in part to the reluctance of the Board of Supervisors, but may have been able to frustrate or inhibit other lessees due to their ownership of exclusive surface rights. However, it stated that the power to negate the enjoyment of a business opportunity by a third party, a stranger, does not constitute the kind of expectancy which lies at the basis of the corporate opportunity doctrine. In addition, the court stated that the opportunity represented a preliminary change in the scope of business of each existing corporation. Ultimately, the court found that the corporate opportunity doctrine did not provide plaintiff with relief, because it requires a derivative claim for disgorgement of profits of the faithless trustee.

Industrial Indem. Co. v. Golden State Co., 49 Cal.2d 255, 316 P.2d 966 (Cal. 1957)

Industrial Indemnity Exchange ("Exchange") was a reciprocal insurance organization handling workmen's compensation insurance. Industrial Indemnity Company ("Company") also handled workmen's compensation insurance. Industrial Underwriters ("Attorney"), a partnership with substantially the same stock ownership as Company, furnished offices and personnel for Company, while acting as an intermediary for the exchange of insurance contracts for participants in Exchange. The Insurance Commission objected to the interlacing by Attorney of its private corporation (Company) and Exchange, and recommended steps to eliminate the possible conflicting loyalties inherent in the arrangement. The parties entered an agreement ("the Transfer and Assumption agreement") whereby the policies of Exchange would be transferred to and reinsured by Company, and consents were obtained from 98% of the subscribers of Exchange. Company brought an action for declaratory relief regarding the rights of nonconsenting subscribers and the trial court rendered a judgment in favor of Company. Two separate sets of defendants appealed, and the appellate court held that the contract between Company and Exchange was illegal and void in violation of section 1101 of the insurance code. The appellate court reversed and remanded directing the trial court to deny all declaratory relief to Company and stating that relief should be granted to appellants with respect to the consequences of the illegality of the transfer and assumption agreement. On remand, the trial court entered judgment and orders adverse to nonconsenting subscribers and intervenor, and they appealed.

The California Supreme Court affirmed the trial court's findings, stating they were supported by evidence and covered the issues the appellate court had ordered retried. Chief Justice Gibson dissented, asserting that the transaction violated the insurance code. Justice Carter also dissented, stating that the factual background supported the conclusions of the district court of appeal's decision on April 30, 1953 (*Industrial Indemn. Co. v. Golden State Co.*, 117 Cal. App. 2d 519, 256 P.2d 677). Justice Carter concluded that when the Transfer and Assumption agreement was executed K.K. Bechtel was president of Company and managing partner of Attorney, and signed the contract on behalf of Attorney as Attorney-in-fact for Exchange, as a member of the Advisory Committee of Exchange and as managing partner of Attorney. Summarizing the findings of the district court of appeal, Justice Carter stated that the corporate opportunity doctrine applies in all situations in which a person manages or transacts business for another or for others to whom he stands in a fiduciary relation without being trustee of an express trust. Justice Carter would have reversed the lower court's decision, and suggested directions that included assigning the net profits made by Company from business directly traceable to former Exchange business to Exchange subscribers.

Kelegian v. Mgrdichian, 33 Cal. App. 4th 982, 39 Cal. Rptr. 2d 390 (Cal. Ct. App. 1995)

Shareholders brought suit against the estate of John Mgrdichian ("Mgrdichian"), a shareholder and member of the board of directors of the California Commerce Club, Inc. ("Club"), a card game casino. Various shareholders alleged that Mgrdichian's purchase of 200 shares, 14 % of the outstanding shares, of Club stock from a fellow board member constituted usurpation of a corporate opportunity. In 1985, Mgrdichian became a shareholder and a member of the board of directors. Another board member testified that he earlier had warned Mgrdichian that his active solicitation of share could expose him to liability to dissatisfied sellers. Mgrdichian maintained that he was acting in his personal capacity and the board took no action to prevent Mgrdichian from acquiring additional Club stock. Club stockholders later authorized the board to acquire sufficient shares necessary to maintain Club's Subchapter S tax status. Mgrdichian completed the disputed stock purchase shortly after the board announced that the share repurchase had been successful. He immediately disclosed his purchase to the board, and the secretary authorized the stock transfers.

The trial court found that plaintiffs failed to carry their burden of proof that the corporation had a specific policy to repurchase shares or that the board took formal action to inform Mgrdichian of such a policy. In addition, the trial court emphasized that the delay in contesting the purchases and lack of formal action to enforce the rights of Club weighed against the plaintiffs. The appellate court affirmed the lower court's decision for Mgrdichian's estate. The Court found that plaintiffs' arguments best fit the "interest or expectancy" test under the corporate opportunity doctrine. Finding no California precedent directly on point, the Court considered a similar factual situation brought before the Oregon court in *Zidell v. Zidell*, 277 Or. 423, 560 P.2d 1091 (1977). As in *Zidell*, the court found that there was no evidence of a formal policy against directors purchasing stock in their corporation or that the corporation made a practice of stock repurchases. The appellate court emphasized that no corporate resolution was ever passed and no action was ever taken to prevent or void any of the transfers, but speculated that plaintiffs had over time convinced themselves that such a policy existed.

Other Jurisdictions:

Regal-Beloit Corp. v. Drecoll, 955 F. Supp. 849 (N.D. Ill 1996)

Plaintiff corporation ("Regal-Beloit") brought suit against its former officers and employees ("Drescoll" et al.) claiming the appropriation of a corporate opportunity. In this opinion, the District Court adopted the opinion and report of a U.S. Magistrate Judge (to whom the matter was referred) granting a preliminary injunction against defendants.

The plaintiff's corporate opportunity claim centered on the right to pursue the acquisition of Brad Foote Gear Works Inc. ("Brad Foote"), a competitor to one of plaintiff's wholly-owned operating divisions ("Illinois Gear"), of which Drecoll was Vice President and General Manager. Drecoll and others at Regal-Beloit had been involved in negotiations with Brad Foote over the potential acquisition of Brad Foote by Regal-Beloit. Although a number of preliminary agreements were drafted, while Drecoll was conducting his due diligence inquiries, Brad Foote abruptly terminated discussions, ostensibly out of concerns that a number of material terms of the acquisition were unfavorable. Nevertheless, Regal-Beloit expressed its ongoing desire to reach an agreement with Brad Foote. At approximately this time Drecoll began separate negotiations with Brad Foote to arrange for Drecoll to acquire the company in his individual capacity. In furtherance of his plan, Drecoll approached other co-workers at Regal-Beloit to recruit them to join him in his venture. At no time did Drecoll or any of the other defendants disclose to Regal-Beloit their personal interest in the acquisition or the terms thereof, until their simultaneous resignation from the firm, some three weeks before the scheduled closing date of the transaction.

In assessing the plaintiff's likelihood of success on the merits, the District Court analyzed explicitly the defendant's assertion that the acquisition had ceased to be a corporate opportunity when Brad Foote broke off negotiations, refusing to deal further with Regal-Beloit. The court was unconvinced by this argument. Noting that the acquisition was clearly within the plaintiff's line of business, the court held that the defendant's failure to disclose (1) their personal interest, and (2) the terms to which Brad Foote would be willing to agree, likely constituted a breach of the defendants' fiduciary duties of loyalty. Citing a number of other notable 'refusal to deal' cases that have reached similar conclusions, the Court noted that in the absence of full disclosure, it is impossible to test the validity of a purported refusal to deal, and in such instances the defense is not available.

Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159 (Mass. 1997)

Arthur Demoulas brought a shareholder derivative action of behalf of Demoulas Super Markets, Inc. ("DSM") and Valley Properties, Inc. ("Valley") alleging that the defendants breached their fiduciary duties by usurping corporate opportunities that should have been presented to DSM and Valley. Based on the expansion of a family supermarket, two brothers, George and Telemachus Demoulas formed DSM in 1964, with the two sides of the Demoulas family owning equal shares in DSM. DSM grew significantly from 1964 to 1970, but when George died suddenly in 1971, Telemachus assumed control of DSM under the terms of a voting trust agreement ("VTA"), which was entered into by DSM shareholders in 1965 designating George and Telemachus as co-trustees. Telemachus became the sole voting trustee at George's death, executor of George's estate and trustee of testamentary trusts established for his children in his will. George's son, Arthur, alleged that the defendants transferred multiple assets from corporations owned by both sides of the family to corporations solely owned by Telemachus, his spouse, his children and grandchildren. Arthur also alleged that the defendants unfairly acquired greater shares of equity in DSM: Telemachus' family share in equity went from 50 for 92 percent.

The Court affirmed the decision that potential bus iness ventures that should have been offered to DSM and Valley, were instead pursued either by the individual defendants or by other companies in which those defendants held ownership interests in breach of defendants' fiduciary duties. The Court stated t hat corporate opportunity doctrine centers upon fiduciaries' obligation not to profit from ventures rightly belonging to a corporation, emphasizing the importance of full disclosure to the corporation and informed rejection by it. It found that where a co rporate opportunity or self -dealing transaction is disclosed to the corporation, but the decision on it is made by self - interested directors, the burden is on those who benefit from the venture to prove that the decision was fair to the corporation. The C ourt rejected the theory that New Hampshire's laws restricting the ownership of liquor licenses made some opportunities legally impossible, which defendants' claimed excused the opening of multiple supermarkets under their sole ownership corporations. The Court held that a defendant cannot invoke the refusal-to-deal defense when the defendant alone had determined the existence of the third party's unwillingness.

Northeast Harbor Golf Club, Inc. v. Harris, 725 A.2d 1018 (Me. 1995)

An action for usurpatio n of corporate opportunities was brought against the former president of a golf course, the plaintiff Northeast Harbor Golf Club ("the Club"), who purchased property adjacent to the Club for subsequent development. Nancy Harris served as president of the Club from 1971 until August of 1990, and although the Board of Directors had some ability to approve policy decision, the president assumed much of the responsibility for managing the Club. From 1972 until 1984, Harris encouraged the Board to consider pur chasing and developing some of the Club's real estate in order to raise money and the Board authorized the formation of a committed to study the proposition of development in more detail in 1977. Harris strongly advocated development in a 1982 meeting and presented a proposal for sale of residential housing in 1984, which were never sold. However, Harris bought land surrounding the Club in her own name in 1979, the Gilpin property, which she learned of as a result of her position, and in 1985, the Smallidge property, without disclosing her purchases until after they had been completed. The Board took no formal action after being informed of Harris' acquisitions, however, when Harris' subdivision plan for the Gilpin property was approved, without taking an y formal action to oppose the subdivision, some members of the Board formed a separate organization to oppose the subdivision.

The Superior Court initially concluded that Harris had not usurped a corporate opportunity because it found that the Club was n ot in the business of developing property and lacked the financial capacity to do so. The Supreme Judicial Court of Maine vacated the judgment and directed the Superior Court to apply the American Law Institute's definition of taking a corporate opportunity. After remand, the Superior Court found that Harris had usurped a corporate opportunity and that the Club claim was not barred by the statute of limitations. The Supreme Court found that Harris had usurped corporate opportunities, but that the six-year statute of limitations and the doctrine of laches barred the Club's claims. The Court articulated that the source of an opportunity is not necessarily determinative, but rather whether it is closely related to a business in which the corporation is engaged or expects to engage. Also, the Court stated that full disclosure is important to prevent individual directors and officers from using their own unfettered judgment to determine whether the business opportunity is related to the corporation's business. In addition, the Court found that doubt as to whether a business opportunity is closely related to the business of the corporation should be resolved in favor of the corporation.