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COMPETING INTERESTS IN THE CORPORATE OPPORTUNITY DOCTRINE

PAT K. CHEW†

The corporate opportunity doctrine governs disputes that arise when a corporate fiduciary pursues a business opportunity that the corporation claims belongs to the corporation. Professor Chew identifies and evaluates the competing policy interests triggered by these disputes, traces the evolution of the corporate opportunity doctrine and examines the traditional tests and emerging models for resolving such disputes. Professor Chew concludes that the traditional and emerging tests inadequately protect legitimate individual and societal interests, and explains the implications of this deficiency. Finally, Professor Chew proposes an alternative means for resolution of corporate opportunity disputes. She recommends express negotiations between corporations and fiduciaries on their respective rights, or, absent such negotiations, a heightened judicial recognition of the parties' reasonable expectations in creating their business relationship.

I. INTRODUCTION

Joe joined the corporation when it was just getting started. Although he was not offered any stock ownership, he liked and respected the family that owned the business. He had a hunch that he could help build the corporation as well as learn more about the specialized electronics industry which he believed had promising potential. His hunch was correct. Over the next ten years, both the corporation and Joe did well. Although the corporation remained closely held by the family, it now had annual revenues above one million dollars and was known in the industry as an established and reliable business with talented management.

Joe was one of the main reasons the management's reputation was so impressive. As vice-president of marketing, and as a director since last year, Joe had learned the intricacies of the specialized electronics market. He made it a point to follow technological developments, reading avidly and participating in professional associations. He thought these activities made good business sense, he enjoyed them, and he thought they helped him develop professionally.

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Through professional meetings and reading journals, Joe followed the work of different scientists, including a member of the engineering faculty at the nearby university. He believed her work was creative and showed promise. In fact, he had discussed with the corporation's directors the idea of hiring her as a consultant for product innovation. Despite Joe's efforts, the family members who controlled the corporation resisted the idea. They believed their traditional product line and marketing approach had served them well in the past and would serve them well in the future.

At a meeting of the regional professional association Joe was approached by the engineer. They discussed at great length her recent invention. Joe recognized it as a significant product innovation in the field. Aware of Joe's particular management and marketing talents, she made him an exciting offer. She wanted to go into business with Joe. Sharing equal equity and management control, she believed they would be a perfect team for a successful new venture.

Joe faced a difficult decision. After weeks of soul searching, he decided to pursue the entrepreneurial venture. While continuing with his corporate responsibilities, he discreetly made preparations. After giving the corporation reasonable notice, he departed.

After two years of hard work, his new company was beginning to show a profit. Everything was going well until, like a bolt out of the blue, Joe received a letter from counsel for his former corporation stating that the corporation claimed he had violated his fiduciary duty under the corporate opportunity doctrine. The corporation was arguing that Joe's company belonged to it. Joe was stunned. He believed that he had been loyal to his former corporation, but he also believed that he had a right to start his own business.

Disputes like the one described above are frequent in American business life. In generations of cases, courts applying the corporate opportunity doctrine have focused on the protection of the corporation's interest.[1] The cases cast the corporation as the surprised, vulnerable, and righteous victim of unscrupulous directors and officers who succumb to their personal greed in derogation of their proper corporate duties. A closer and more thoughtful analysis of actual corporate opportunity disputes and their consequences reveals that this picture is simplistic and unrealistic.[2]

1. Early United States cases include Murray v. Vanderbilt, 39 Barb. 140 (N.Y. 1863); Blake v. Buffalo Creek R.R., 56 N.Y. 485 (1874); Steinway v. Steinway, 2 A.D. 301, 37 N.Y. Supp. 742 (1st Dept. 1896), *aff'd*, 53 N.E. 1132 (1899). Other countries have recognized the corporate opportunity doctrine only more recently. For a discussion of landmark cases in foreign countries and issues raised, see Atkinson & Spence, *Fiduciary Duties Owed by Departing Employees—the Emerging "Unfairness" Principle*, 8 CAN. BUS. L.J. 501 (1983-84); Comment, *The Corporate Opportunity Doctrine in New Zealand*, 5 OTAGO L. REV. 496 (1983). For a United States court's interpretation of the Canadian corporate opportunity doctrine, see Messinger v. United Canso Oil & Gas Ltd., 486 F. Supp. 788, 796 (D. Conn. 1980).

2. The author conducted a comprehensive analysis of corporate opportunity cases reported between April 1977 and April 1988. The analysis is the basis for certain factual and analytical assumptions about corporate opportunity disputes made throughout this Article.

The analysis revealed that these disputes usually occur in close corporations in a wide range of

While the corporation has legitimate interests to protect, the outcomes of corporate opportunity disputes also trigger legitimate and significant societal and individual interests. Courts have recognized these interests in other areas of law[3] but surprisingly have not acknowledged them, except in a few cases, in the corporate opportunity area. This tendency probably results from their not having explored the actual consequences of corporate opportunity cases. This Article argues the cost of continuing to ignore these consequences is too high.[4]

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industries, frequently a family business or one started by friends. The defendants are traditional corporate fiduciaries such as directors and officers, or, as is occurring more frequently, the defendants are nontraditional fiduciaries such as key employees. The opportunities these individuals pursue are often directly competitive to the corporation, which suggests that there may be significant parallels between employment noncompetition laws and the corporate opportunity doctrine. The analysis also indicated that courts are moving away from the traditional corporate opportunity tests and gravitating toward the use of one or more new models to resolve disputes. These and other findings are elaborated on in this Article.

There could be a variety of reasons for the paucity of litigated cases in publicly held corporations. First, the corporation and fiduciaries may have a prior understanding on resolving corporate opportunity disputes. This understanding may be stated explicitly in an employment contract or in a corporate policy statement. While provisions in these documents dealing with corporate opportunities per se would be unusual, provisions on noncompetition, use of corporate property, self dealing transactions, and insider trading are not unusual. Disputes arising from these documents are more likely to be viewed as breach of contract issues rather than corporate opportunity issues. In addition, the corporation and fiduciaries may have an unarticulated yet implicit agreement regarding corporate opportunities that is enforced through industry and business practices rather than through the courts. For example, the reputation of fiduciaries or corporations that engage in unacceptable conduct regarding opportunities can be significantly harmed. In the tightly-knit circle of top level fiduciaries in a given industry, harm to reputation is a powerful deterrent to undesirable conduct.

Another explanation for the paucity of litigated cases in publicly held corporations is that these cases may be settled pretrial. Both parties are likely to be eager to resolve the dispute promptly and to have ongoing legal counsel ready to move forward quickly with settlement negotiations. Although close corporations and their fiduciaries are also eager to resolve disputes promptly, they may have another agenda. Because of the close working relationships between the individual defendants and plaintiffs, they may take the dispute more personally and be motivated "on principle" and by a sense of betrayal to punish publicly or to prove definitively through the courts that their position is correct. Since this personal intensity is less likely to exist in publicly held corporations, the corporation may not even initiate a lawsuit. Finally, the opportunities of interest to a publicly held corporation may be so large that individual fiduciaries would not have the resources to pursue them.

For an analysis of early corporate opportunity cases, see Brudney & Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 997, 1007-22 (1981).

3. Laws outside the corporate opportunity doctrine area consider competing interests when both the employee and the corporation have an interest in the same opportunity or property. An example is the laws governing ownership rights of inventions created by employees. CALIF. LAB. CODE § 2870 (West Supp. 1988); ILL. ANN. STAT. ch. 140, para. 302 (Smith-Hurd 1986); *see also* Coolley, *Recent Changes in Employee Ownership Laws: Employers May Not Own Their Inventions and Confidential Information*, 41 BUS. LAW. 57 (1985) (describing recent cases and statutes on employer versus employee ownership of inventions and confidential information). The laws governing trade secrets also consider the interests of the corporate user of the trade secrets, the employees, competitors of the trade secrets user, and broader societal interests. Robison, *The Confidence Game: An Approach to the Law about Trade Secrets*, 25 ARIZ. L. REV. 347, 354-63 (1983) (summarizing competing interests in disputes over trade secrets).

4. Conclusions about societal costs and fundamental policy issues are based ideally on an analysis of both litigated and nonlitigated corporate opportunity disputes. Reliance on only litigated cases has limitations because they are not necessarily representative of all disputes and their resolutions. For example, the litigated cases tend to be the close cases. *See* Cartwright, *Disputes and Reported Cases*, 9 LAW & SOC'Y REV. 369 (1975) (discusses problems in relying on reported cases). Corporations and their fiduciaries may settle their disputes in a variety of constructive and creative ways that take into account both their interests. Fiduciaries may return the opportunity to the corporation in exchange for a return of capital and a reasonable return on their investment or the parties may decide to develop jointly the opportunity. *See also infra* note 335 (discussing forms of joint development).

For example, the practical consequences for corporate fiduciaries are drastic. In many instances fiduciaries who lose corporate opportunity lawsuits are effectively prohibited from competing with their former corporations. This results even though the fiduciaries have not signed noncompetition agreements. Such de facto restraints are contrary to individuals' rights to pursue freely their interests and talents and to society's long-standing goal of promoting competition. This consequence is especially worrisome because the categories of individuals subject to the doctrine, and hence subject to a prohibition against competition, are expanding.[5]

In addition, the outcomes of corporate opportunity disputes can hinder the creation of successful new businesses. This concern is particularly significant because over the last two decades, small and medium sized companies have been the largest source of economic growth in this country.[6]

The optimal goal is for promising opportunities to be successfully developed without harming the corporation or disregarding the legitimate interests of fiduciaries and society. The objective is to find societally constructive and cooperative solutions to corporate opportunity disputes that enhance rather than hinder the corporate-fiduciary relationship.[7] Yet the traditional corporate opportunity tests, at least overtly, ignore noncorporate interests. For example, the "line of business" test is the most widely cited traditional corporate opportunity test.[8] Its key inquiry, as applied to Joe, is whether Joe's company is in competition with the corporation. Since it probably is, Joe is precluded from pursuing the opportunity and is deemed to have held the opportunity in trust for the corporation. This test and outcome clearly protect the corporation's interest. The test, however, ignores policy concerns about Joe's and society's interests.

Some courts are moving away from the traditional tests and gravitating toward one or more new models for resolving corporate opportunity disputes. These models may be labeled as the corporate expectations model, the corporate capability model, and the disclosure model. The corporate expectations model resolves disputes based on what the corporation would reasonably expect to occur.[9] As applied to Joe, if the corporation, in the court's opinion, would reasonably expect that the opportunity belongs to it, then Joe is precluded from pursuing the opportunity. The corporate capability model focuses on whether the corporation is able to develop the opportunity.[10] If it is not able, for whatever legal, financial, or business reasons, then Joe may exploit the opportunity. The disclosure model focuses on whether Joe discloses the opportunity to

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5. *See infra* text accompanying notes 41-47.

6. D. Birch, Job Creation In America: How Our Smallest Companies Put the Most People to Work 6-16 (1987); *see also infra* text accompanying notes 48-64 (societal benefits from the successful development of business opportunities).

7. For example, some form of joint development of the opportunity may be the most efficient and mutually beneficial arrangement. *See infra* note 335 (discussing cooperative and joint development of opportunities by the fiduciary and the corporation).

8. *See infra* text accompanying notes 67-82.

9. *See infra* text accompanying notes 187-225.

10. *See infra* text accompanying notes 140-86.

the corporation, and the corporation's reaction to that disclosure.[11] If Joe discloses and the corporation consents, Joe may pursue the opportunity. Because, in our example, Joe did not disclose the opportunity and his interest in pursuing it, he violated his duty to the corporation and cannot continue his business.

These models have certain advantages. For example, the corporate capability model promotes economic efficiency, and the disclosure model is reasonably objective and monitorable. Like the traditional tests, however, they suffer from a fundamental inadequacy: they do not directly consider individual or societal interests. For example, the corporate capability model, while focusing on the corporation's ability or inability to pursue the opportunity, does not consider whether Joe may be especially, even uniquely, well suited to exploit the opportunity successfully. The corporate expectations model studies the corporation's expectations, neglecting the fact that Joe may also have what he considers legitimate expectations of pursuing the opportunity. The disclosure model imposes significant disclosure obligations on Joe, but does not inquire whether the corporation should have some reciprocal notice or disclosure obligations to Joe.

This Article offers a solution that accommodates both legitimate corporate and noncorporate interests. It proposes that future disputes be resolved according to the expectations of both the corporation and the fiduciaries. In the optimal situation the parties will have an express agreement on how they expect to resolve corporate opportunity disputes. In the absence of an agreement, the courts should determine what their reasonable expectations would have been.

Thus, this Article is distinguishable from the existing legal literature in two ways. First, it argues that the corporate opportunity doctrine should acknowledge and protect legitimate individual and societal interests, as well as legitimate corporate interests. Seemingly oblivious to noncorporate interests, courts and other commentators instead have focused on the adequacy of the doctrine's protection of corporate interests.[12] Second, the Article argues that corporate opportunity disputes should be resolved in ways that are consistent with the reasonable expectations of both the corporation and the fiduciaries. This conceptual framework is a departure from the current doctrine which predicates liability on the basis of the defendants' fiduciary status and the protection of the corporation's interest.

This Article begins with a discussion of the competing policy interests found in corporate opportunity cases. It then studies the evolution of the corporate opportunity doctrine, including a review of the traditional corporate oppor-

11. *See infra* text accompanying notes 226-83.

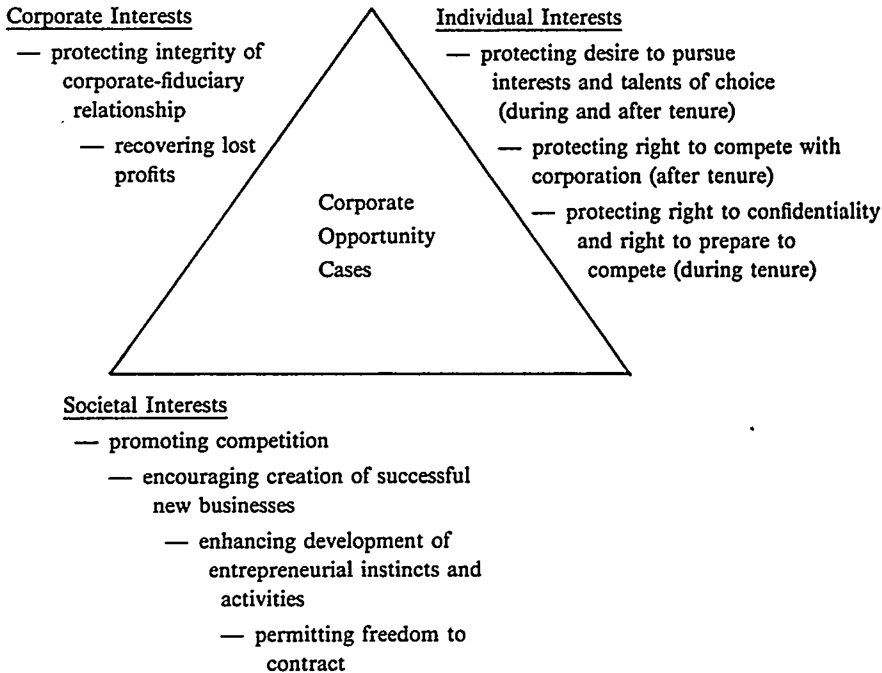
12. Commentators offer various solutions for protecting the corporate interest. *See* Brudney & Clark, *supra* note 2, at 1022-24 (categorical prohibition on full-time fiduciaries of public corporations); Note, *Corporate Opportunity and Corporate Competition: A Double-Barreled Theory of Fiduciary Liability*, 10 HOFSTRA L. REV. 1193 (1982) [hereinafter Note, *Corporate Competition*] (advocating compliance with both the corporate opportunity doctrine and the employment noncompetition laws); Note, *When Opportunity Knocks: An Analysis of the Brudney & Clark and ALI Principles of Corporate Governance Proposals for Deciding Corporate Opportunity Claims*, 11 J. CORP. L. 255 (1986) [hereinafter Note, *Opportunity Knocks*] (advocating not only rejection of opportunity by the board of directors but also unanimous shareholder consent before the fiduciary is allowed to develop the rejected opportunity).

tunity tests and a thorough discussion of the emerging new corporate opportunity models. Finally, the Article explores the proposed reasonable expectations model for resolving future corporate opportunity disputes.

II. Competing Policy Interests

The corporate opportunity doctrine should directly acknowledge and articulate the relevant corporate and noncorporate interests; as illustrated in Figure 1.[13] Although this Article discusses the interests of the corporation, fiduciaries,

FIGURE 1. COMPETING INTERESTS



and society separately, they may share common concerns. For example, the integrity of the corporate-fiduciary relationship, as described below, allows corporations and fiduciaries to work in an atmosphere of trust and stability so that

13. There is some indication that the corporate laws governing other fiduciary duties are beginning to recognize the legitimacy of noncorporate interests. Under the Pennsylvania statutes codifying the duty of due care, for example, fiduciaries are expressly permitted to consider the effects of their action upon employees, suppliers, and customers of the corporation, and the communities in which the corporation is located. These interests, however, are derivative—they are justified only in determining the "best interests of the corporation." 42 PA. CONS. STAT. ANN. § 8363 (Purdon Supp. 1988). The increased latitude and flexibility in the standard of the fiduciaries' duties also serve the corporate interest because it enables corporations to attract directors and officers. *See also* Solomon & Collins, *Humanistic Economics: A New Model for the Corporate Social Responsibility Debate,* 12 J. CORP. L. 331, 337-51 (1987) (proposing that the corporation redirect its goals from pure profit maximization to development of human potential of corporate employees).

they can direct their cooperative efforts toward the corporation's economic productivity.

By openly discussing these different interests and their interrelationships, courts, legislators, and commentators can define policy goals reflecting these different interests. As these policy goals are determined, empirical and other scholarly research can begin to identify what actually promotes the goals. For instance, do rigid restrictions on fiduciaries' activities, regardless of the specific circumstances, strengthen the integrity of corporate-fiduciary relationships? This assumption apparently underlies the traditional trustee-oriented corporate opportunity doctrine. Or, as argued later in this Article, are fairly negotiated and clearly delineated rights and obligations of both the fiduciaries and the corporation more likely to promote the integrity of the relationship?

A. *The Corporate Interest*

Two corporate interests are: (1) maintaining the integrity of the relationship between the fiduciaries and the corporation, and (2) avoiding the direct economic harm incurred when the corporation is deprived of an opportunity.[14]

14. The corporation also may be concerned that prospective investors and shareholders will lose confidence in the corporation because of their fear of the fiduciaries' possible diversion of opportunities. As their confidence diminishes, they will stop investing in the corporation and shift their investment to other alternatives. Brudney & Clark, *supra* note 2, at 1028-30; *cf.* Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 48 (1980) (noting that investors may discount the amount they will pay for shares due to the risk of insider trading); Wang, *Trading in Material Nonpublic Information on Impersonal Stock Markets: Who is Harmed, and Who can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1229 (1981) (questioning whether insider trading activities influence investors' behavior). The legitimacy of this corporate interest, however, is predicated on the improbable assumption that investors know and care about the corporate opportunity doctrine. Professors Elliott J. Weiss and Lawrence J. White demonstrate that these types of assumptions can sometimes be tested. *See* Weiss & White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CALIF. L. REV. 551, 566-67 (1987).

The corporation also has an interest in protecting what is clearly corporate property. In particular, the corporation is concerned that the fiduciaries will misappropriate intangible property such as confidential proprietary information or trade secrets. Case law and statutes outside the corporate opportunity area prohibit fiduciaries and other employees from using the corporation's proprietary information or know-how improperly and provide remedies if misappropriation occurs. *See, e.g.*, Annotation, *What Is "Trade Secret" So As to Render Actionable Under State Law Its Use or Disclosure By Former Employee*, 59 A.L.R.4TH 641 (1988) (cases determining what constitutes trade secrets); *see also* Brudney & Clark, *supra* note 2, at 1009 (determining what constitutes corporate resources). The corporation may also be concerned about misappropriation of tangible property. For example, fiduciaries may develop an opportunity by improperly using tangible corporate property such as office equipment, research facilities, supplies, or corporate personnel. Courts have cited the relevance of the fiduciaries' use of corporate resources in their analyses of corporate opportunity claims as a factor in assessing unfairness, bad faith, or in other tests for liability used in the jurisdiction. *See, e.g.*, Banks v. Bryant, 497 So. 2d 460, 462-63 (Ala. 1986) (reimbursement for use of resources not relevant); Lewis v. Fuqua, 502 A.2d 962, 970 (Del. Ch. 1985) (committee finding that no corporate funds were used by directors when they purchased stock for themselves is not dispositive as to whether a corporate opportunity existed), *appeal denied sub nom.* Fuqua Indus. v. Lewis, 504 A.2d 571 (Del. 1986); Graham v. Mimms, 111 Ill. App. 3d 751, 763, 444 N.E.2d 549, 557 (1982) (fiduciary's use of corporate resources to develop a business opportunity for himself will not be permitted); Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 302-03, 438 N.E.2d 391, 395 (1982) (even though the alleged trade secret was generally known, the trade secret issue retained significance because the corporate opportunity doctrine deals with obtaining an opportunity); Lowder v. All Star Mills, Inc., 75 N.C. App. 233, 240, 330 S.E.2d 649, 654, *review denied*, 314 N.C. 541, 335 S.E.2d 19 (1985).

Because courts have long acknowledged corporate interests, they are discussed more briefly than noncorporate interests.

1. Integrity of the Fiduciary-Corporate Relationship

Corporate fiduciaries are in positions of trust. In order to fulfill their general responsibilities and make key decisions, they must have access to extensive and confidential information. They also have significant decision making authority to direct and implement major corporate policies. As representatives of the corporation, they are in contact with individuals and entities, including suppliers, distributors, and customers, that serve the corporation's operational needs. Because of their corporate positions and activities, fiduciaries are exposed to opportunities of interest to the corporation and of possible personal interest to themselves.

The corporation relies on fiduciaries to fulfill their duties in good faith and with integrity. The corporation provides them with access to information and contacts so that the fiduciaries can perform effectively, not so that they can exploit these resources for their own personal benefit. Although individuals assume fiduciary roles to serve their personal and professional objectives as well as the corporation's needs, the corporation is concerned that these personal interests may conflict with corporate interests—that fiduciaries will allow their personal interests to overcome their corporate loyalty and will betray the corporation's trust. The corporation does not want to have to speculate about or monitor the fiduciaries' honesty and fair-dealing. It wants assurance that when the fiduciaries make corporate decisions, those decisions are not tainted by personal interests.

2. Direct Economic Injury

A second corporate concern is the direct economic harm[15] that the corporation suffers when deprived of a chance to develop the opportunity. This harm is very difficult to determine, especially if there is no actual economic loss to the corporation. The corporation could claim the loss of profits it would have re-

15. Although early courts did not analogize trust law and the remedy of the constructive trust to the corporate opportunity doctrine to serve as a diversionary device, this analogy in more recent court decisions has shifted the courts' attention away from the issue of how and to what extent the corporation was harmed. The constructive trust remedy, unlike a damages remedy, is not based on notions of harm but rather on principles of trust law. *See, e.g.*, Graham v. Mimms, 111 Ill. App. 3d 751, 763, 444 N.E.2d 549, 556 (1982). Few recent cases even mention harm. *Compare* Master Records, Inc. v. Backman, 133 Ariz. 494, 497, 652 P.2d 1017, 1020 (1982) (in discussing both corporate opportunity and employment noncompetition doctrines, indicating that engaging in a competing business is acceptable unless the fiduciaries deliberately cause injury to corporation) *with* Ampersand Prods., Inc. v. Stahl, No. 85-4358 (E.D. Pa. Feb. 20, 1986) (LEXIS, Genfed library, Omni file) (unjust enrichment of defendant rather than harm to corporation is the relevant concern).

Certain conditions would seem to increase the probability that the fiduciaries harmed the corporation. These conditions may relate to (1) the corporation itself (e.g., particular vulnerability because of depleted resources, disloyal customers, or financial instability), (2) the opportunity (e.g., the opportunity is directly competitive with the corporation, the new company has a competitive advantage (technological innovation, key talent, or strategic location), or the opportunity is not reasonably easy to substitute), or (3) the geographic or product market in which the corporation is located (e.g., the market is limited and the opportunity was one of the few avenues for expansion).

ceived if it had developed the opportunity. A determination of the difference between the profits the corporation would have received if the fiduciaries had not developed the opportunity and the profits the corporation actually received would then be appropriate, although very difficult to ascertain. Whether the corporation would have developed the opportunity, if the fiduciaries had not, may be uncertain. Moreover, whether the corporation would have received the same amount of profit as the fiduciaries actually received may be equally speculative.

The corporation's argument for lost profits is most persuasive if the corporation's entitlement is based on a contract right to the opportunity. A contract provides tangible evidence of the corporation's expectation of and reliance on pursuing the opportunity. On the other hand, the argument for lost profits is least persuasive if the corporation would not have had the capability to develop the opportunity.[16] It is difficult for the corporation to claim lost profits or other economic injury from an opportunity that it could not actually have developed.

Furthermore, the corporation could not claim lost profits from a hypothetical sale of the opportunity to a third party who could develop it. Without separate legal grounds on which to base the corporation's claims to the opportunity (such as a contract right or proprietary intellectual property), the corporate opportunity doctrine could preclude only the fiduciaries, but not a third party, from pursuing the opportunity. In other words, the corporation has no proprietary interest to sell.

B. *Individual Interests*

The corporate opportunity doctrine as it is presently understood precludes an express consideration of individual interests and rights.[17] These interests should be acknowledged and studied for at least three reasons: (1) the outcomes of corporate opportunity disputes often have drastic consequences for the fiduciaries involved; (2) fiduciaries have legitimate rights and expectations regarding the opportunities; and (3) the expansion of the number and categories of individuals who are subject to and hence affected by the corporate opportunity doctrine. The following discussion explores individual interests in depth because they have not been explored in this context before. While these individual interests are important, neither they nor societal interests should be given a presumption of priority over corporate interests. This Article argues for consideration,

16. *See* Freeman v. Decio, 584 F.2d 186, 193 (7th Cir. 1978) (analogizing corporate opportunity doctrine to insider trading and considering whether the corporation was in a position to use the opportunity as a measure of whether loss or harm to the corporation was possible). *But see In re* Orfa Sec. Litig., 654 F. Supp. 1449, 1457 (D.N.J. 1987) (rejecting *Freeman*'s analysis of insider trading).

17. Courts direct attention to fiduciaries only to determine if they acted improperly, if their conduct harmed the corporation, or if they learned of the opportunity in their personal or corporate capacities. *See* Tuckman v. Aerosonic Corp., No. 4094 (Del. Ch. May 20, 1982) (LEXIS, States library, Omni file); Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978); Chemical Dynamics, Inc. v. Newfeld, 728 S.W.2d 590, 593 (Mo. App. 1987); Fender v. Prescott, 64 N.Y.2d 1077, 1078-79, 489 N.Y.S.2d 880, 880-81, 479 N.E.2d 225, 225-26 (1985).

not domination, of noncorporate interests in corporate opportunity disputes.[18]

1. Consequences for the Fiduciaries

The outcomes of corporate opportunity lawsuits can have drastic effects on fiduciaries' activities during their tenure as fiduciaries and upon their right to compete with the corporation after their tenure. An understanding of these consequences begins with a review of a typical fact pattern and the traditional remedy in corporate opportunity cases.[19] In the typical fact pattern the fiduciaries identify, investigate, negotiate, decide to pursue, and make preliminary plans for the opportunity. They then resign their fiduciary roles, actively begin a competing business, and ultimately develop the opportunity into a profitable venture. The fiduciaries usually have not signed noncompetition agreements.[20]

If the court deems the opportunity to belong to the corporation and the fiduciaries breached their duty in taking it, the traditional remedy is a constructive trust. A constructive trust recovers for the corporation not only the opportunity (principal), but all profits and any accruing appreciation (interest). This remedy applies even though the fiduciaries may have made significant contributions of their time, talent, and personal funds to develop the opportunity, the corporation may have actually benefitted from the opportunity, or the fiduciaries did not benefit from the opportunity.[21]

The practical consequences of applying this remedy in the typical fact pattern is that fiduciaries must give up their new businesses and are precluded from

18. If any interest is given priority, out of deference to past and current corporate opportunity doctrine, the corporation's interest arguably should be given that status.

19. See author's analysis of cases, *supra* note 2. *See, e.g.*, United Seal & Rubber Co. v. Bunting, 248 Ga. 814, 815-16, 285 S.E.2d 721, 722-23 (1982); Peterson Welding Supply Co. v. Cryogas Prods. Inc., 126 Ill. App. 3d 759, 764, 467 N.E.2d 1068, 1072 (1984); Maryland Metals, Inc. v. Metzner, 282 Md. 31, 37-41, 382 A.2d 564, 568-70 (1978); Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 300-02, 438 N.E.2d. 391, 394-95 (1982).

20. Where there is a noncompetition covenant, some corporations have brought separate but concurrent causes of action: the first based on the covenant and the second based on the corporate opportunity doctrine. *See, e.g.*, Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 960 (Del. 1980); Southeast Consultants, Inc. v. McCrary Eng'g Corp., 246 Ga. 503, 504, 273 S.E.2d 112, 114 (1980); Wilmington Trust Co. v. Consistent Asset Management Co., No. 8867 (Del. Ch. Mar. 25, 1987) (LEXIS, States library, Omni file). Thus, if the noncompetition covenant is not enforceable or if the fiduciaries' objectionable conduct is beyond the scope of the covenant's terms, the corporate opportunity doctrine may serve as an alternative theory for the corporation. The existence, however, of the noncompetition covenant substantiates that the parties considered and resolved the problem of competing opportunities. Imposing the corporate opportunity doctrine as an alternative theory is inconsistent with the parties' expectations. The noncompetition covenant should govern exclusively a dispute over the fiduciaries' taking of a competing opportunity, although the corporate opportunity doctrine could be used if the corporation also is contesting the fiduciaries' taking of a *non*competing opportunity. *But see* Note, *Corporate Competition*, *supra* note 12, at 1225 (recommending that both noncompetition law and the corporate opportunity doctrine should be applied to every dispute, thus imposing the maximum restrictiveness on fiduciaries' activities).

21. RESTATEMENT OF RESTITUTION §§ 190, 194 & 199 (1937); *see also* Farber v. Servan Land Co., 662 F.2d 371, 380 (5th Cir. Unit B. Nov. 1981) (value of the land owned by the corporation increased because the corporate land and the contested land were sold together); CST, Inc. v. Mark, 360 Pa. Super. 303, 310, 520 A.2d 469, 472 (fiduciary was responsible for lost profits, even though the fiduciary never received any profit), *appeal denied*, 517 Pa. 630, 539 A.2d 811 (1986). A few cases use a damages remedy. *See* S.N.T. Indus. v. Geanopulos, 363 Pa. Super. 97, 105, 525 A.2d 736, 741 (1987) (damages plus a punitive award); BBF, Inc. v. Germanium Power Devices Corp., 13 Mass. App. Ct. 166, 176-77, 430 N.E.2d 1221, 1227 (1982).

competing with the corporation by virtue of that opportunity. Thus the remedy afforded by the corporate opportunity doctrine effectively imposes upon fiduciaries a common law restraint on competing against their former corporation. Although the doctrine permits fiduciaries to pursue commercial activities that are not related to the original opportunity or not susceptible to another corporate opportunity violation, typically the opportunity is the integral foundation on which the fiduciaries built the new business.[22] Its transfer back to the corporation handicaps or effectively terminates the fiduciaries' business.

Although the corporation probably will reimburse the fiduciaries for the price the fiduciaries paid for the opportunity, and the fiduciaries perhaps will receive some "salary," they lose the appreciated value of the opportunity attributable to their entrepreneurial efforts, skills, and risk taking. In essence their returns from the venture are based on an employee and not an equity status. These former fiduciaries have lost the rewards of ownership—the prime reason they were willing to undertake the considerable challenge and risks of starting their own business. Instead they have involuntarily developed the opportunity for the corporation.

This noncompetition restraint generally is imposed even though the fiduciaries resign from the corporation before opening the doors of their new business.[23] Thus, the doctrine restricts former fiduciaries even though their fiduciary positions have terminated.[24] Most courts have not addressed the effect of the fiduciaries' resignation and presumably take for granted that the fiduciaries' resignation is not relevant.[25]

22. *See, e.g.*, Science Accessories Corp. v. Summagraphics, 425 A.2d 957 (Del. 1980); Energy Resources Corp. v. Porter, 14 Mass. App. 296, 438 N.E.2d 391 (1982); Production Finishing Corp. v. Shields, 158 Mich. App. 479, 405 N.W.2d 171 (1987).

23. *See, e.g.*, Stagenberg v. Allied Distrib. & Bld. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file).

24. *Id.*; *see infra* note 25. Determination of when the duty begins presents a related issue. For example, if directors are selected but have not begun their terms, and in the interim they learn of an opportunity and begin to pursue it, the opportunity may become subject to the doctrine when the fiduciaries' term begins, or courts may deem the opportunity to have come to the fiduciaries in their individual capacities. Another consideration is whether the fiduciaries learned of the opportunity before learning of their selection as directors.

25. Cases that have addressed the issue are divided. *Compare* Gregg v. United States Indus., 715 F.2d 1522, 1541 (11th Cir. 1983) (once the defendant was removed as president, the corporate opportunity doctrine was preempted since there were no fiduciary duties to trigger it), *cert. denied*, 466 U.S. 960 (1984); Master Records, Inc. v. Backman, 133 Ariz. 494, 497-98, 652 P.2d 1017, 1020-21 (1982) (en banc) (fiduciary duty terminates upon resignation); *with* Comedy Cottage, Inc. v. Berk, 145 Ill. App. 3d 355, 369, 495 N.E.2d 1006, 1011 (1986) (resignation does not terminate the duty because the seed of the opportunity was planted prior to the resignation); Graham v. Mimms, 111 Ill. App. 3d 751, 765, 444 N.E.2d 549, 558 (1982) (same), *cert. denied*, 93 Ill. Rep. 2d 542 (1983); Stangenberg v. Allied Distrib. & Bldg. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file) (same). The court's determination of when the "seed" was planted may be unclear but the opportunity's "seed" tends to be traced to an extenuated and unrealistic origin. *See, e.g., Comedy Cottage*, 145 Ill. App. 3d at 360-61, 495 N.E.2d at 1011 (indicating a seed has been planted whenever the opportunity is founded on information acquired during the relationship, even though the information is not of trade secret status). Considering the wide range of information about the corporation and industry to which fiduciaries are routinely exposed, it is difficult to imagine any opportunity that could not be traced back to some general information the fiduciaries acquired during their tenure. *See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.05(b) comment (Tent. Draft No. 5, 1986) [hereinafter ALI Draft] (duty arises only if corporate opportunity comes into existence during tenure as a fiduciary). Recog-

Moreover, courts have assumed implicitly that fiduciaries may have breached their duty even though only preparatory steps to starting the business were taken during the fiduciaries' tenure, if those preparatory steps culminate in exploitation of the opportunity.[26] Prohibiting the fiduciaries' active competition against the corporation during their tenure is consistent with basic principles of the duty of loyalty.[27] The corporate opportunity doctrine, however, also impinges upon the fiduciaries' preparing to compete, making inquiries, and gathering information. These activities may be tainted by the fiduciaries' ultimate action of starting a competing business, and thus the doctrine exercises a chilling effect on them.

In addition, some courts require that fiduciaries disclose the opportunity and their interest in it to the corporation.[28] This mandate infringes upon fiduciaries' general right to keep their personal plans confidential until it is otherwise necessary to give reasonable notice of their departure to the corporation. This imposes on the fiduciaries' preparation for departure and violates the confidentiality of their personal plans by forcing the fiduciaries to reveal their intent to leave before they actually determine their future plans.

The inference from these cases is that fiduciaries who want to be certain that they are not violating their fiduciary duties should quit their positions before doing any investigating or preparing for other opportunities. While this may be plausible for part-time fiduciaries such as outside directors, very few full-time fiduciaries are in a position, except at great personal sacrifice, to take this course of action.

2. Individuals' Legitimate Rights

The corporate opportunity doctrine assumes that fiduciaries are only entitled to an opportunity by default; only if the corporation is not entitled to it can they obtain the right to the opportunity.[29] Fiduciaries, however, may have legitimate claims to the opportunity even from the outset. In the same way the corporation does, the individuals may have an independent basis for arguing that the opportunity belongs to them. If the opportunity belongs to the individuals, then the corporation's exploitation of the opportunity actually would be an infringement of the individuals' rights. Other areas of the law, such as the employment noncompetition area, acknowledge and legitimize the individuals' rights in analogous circumstances.[30] This basic idea, however, has not been recognized in the corporate opportunity area.

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nizing that opportunities "germinate" over a period of time, the American Law Institute notes that fiduciaries who resign during the germination period are subject to a duty to disclose only if it is "fair" to the corporation to so disclose. ALI Draft, *supra*, § 5.05(b) comment, at 116.

26. Some courts scrutinize the fiduciaries' conduct, including any preparatory steps undertaken prior to their departure from the corporation. *E.g.*, Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 297-98, 438 N.E.2d 391, 392-93 (1982); Klinicki v. Lundgren, 298 Or. 662, 683, 695 P.2d 906, 920 (1985) (en banc); Nicholson v. Evans, 642 P.2d 727, 728-30 (Utah 1982).

27. H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 628 (3d ed. 1983).

28. *See infra* note 226.

29. *See supra* text accompanying notes 20-24.

30. *See supra* note 3; *infra* note 304.

One explanation for the lack of recognition of individuals' rights is historical. When fiduciaries were offered opportunities that might be of interest to their corporation, courts originally equated their standard of conduct with that of trustees.[31] This analogy resulted in a rigid standard which strongly advocated the strict liability of fiduciaries and, consistent with trust law, imposed the harsh remedy of a constructive trust.[32] Under trustee law principles, the rights and interests of the beneficiary are exclusive.[33]

As the following discussion substantiates, however, the trustee-beneficiary relationship is no longer (if it ever was) an appropriate standard for the fiduciary-corporate relationship.[34] The fiduciary-corporate relationship is more

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31. Guth v. Loft, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939); Hooker v. Midland Steel Co., 215 Ill. 444, 451, 74 N.E. 445, 447 (1905); Bosworth v. Allen, 168 N.Y. 157, 164, 61 N.E. 163, 164 (1901); Blake v. Buffalo Creek R.R., 56 N.Y. 485, 491 (1874).

32. RESTATEMENT (SECOND) OF TRUSTS § 170 (1959); G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES §§ 543, 543(O), 543(V) (1960 & Supp. 1988). One commentator described the high standards imposed on trustees:

> A trustee is under a duty to the beneficiary of the trust to administer the trust solely in the interest of the beneficiary. The trustee must exclude all self-interest, as well as the interest of a third party, in his administration of the trust solely for the benefit of the beneficiary. The trustee must not place himself in a position where his own interests or that of another enters into conflict, or may possibly conflict, with the interest of the trust or its beneficiary. Put another way, the trustee may not enter into a transaction or take or continue in a position in which his personal interest or the interest of a third party is or becomes adverse to the interest of the beneficiary.

G. BOGERT, *supra*, § 543.

33. *See* G. BOGERT, *supra* note 32, §§ 543, 543(O), 543(V).

34. The trustee analogy was predicated on certain fundamental assumptions about the human nature of fiduciaries. Courts perceived fiduciaries as having the predilection, in the absence of any legal restraints, to put their personal interests before those of the corporation. *See* Guth v. Loft, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939); G. BOGERT, *supra* note 32, § 543. To prevent such bad faith actions, the courts decided to remove any temptation to misappropriate an opportunity belonging to the corporation. *Guth*, 23 Del. Ch. at 270, 5 A.2d at 510.

Various studies suggest that the cause of misconduct is actually a corporate environment that condones misconduct and unethical behavior, not the individuals' predispositions. Wartzman, *Nature or Nurture? Study Blames Ethical Lapses on Corporate Goals*, Wall St. J., Oct. 9, 1987, at 27, col. 4. *See generally* Frederick & Weber, *The Values of Corporate Managers and their Critics: An Empirical Description and Normative Implications* in 9 RESEARCH IN CORPORATE SOCIAL PERFORMANCE AND POLICY 131, 147-50 (1987) (empirical inquiry into business ethics and values). Thus, the trustee analogy may have been inappropriate.

> One wonders if even the fiduciary role is still appropriate for directors and officers. Commentators have noted that fiduciaries in general have certain characteristics: (1) they substitute for the corporation and shareholders, (2) they receive their power from the corporation and shareholders, and (3) they have access to much more information than the shareholders.

Clark, *Agency Costs versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 77 (1985); Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 808-09 (1983). These characteristics both confirm the fiduciaries' positions of trust and make their potential abuse of discretion more probable. Clark, *supra*, at 77; Frankel, *supra*, at 808-09; *cf.* Sheperd, *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51, 75 (1981) ("a fiduciary relationship exists whenever any person receives a power of any type on condition that he also receive with it a duty to utilize that power in the best interests of another, and the recipient of the power uses that power"); Seigel, *The New Fiduciaries: Some Observations on the Imposition of Extra-Contract Duties in Consumer Transactions* (unpublished manuscript on file with author) (discussing evolution of different types of fiduciary duties).

Yet most litigated corporate opportunity disputes occur in close corporations. *See supra* note 2. In these entities, directors, officers, key employees, and shareholders are often the same people. A close identity thus exists between the fiduciaries and the corporation. In a practical sense, the common characteristics of fiduciaries described above do not exist. The fiduciaries instead are essentially

analogous to an agency, employee, or partnership relationship in which both parties have recognized the duties and rights of the other and such rights and duties are flexibly negotiated.[35] When the corporation and the fiduciaries enter into their relationship, they are concerned about protecting their own interests but acknowledge the existence and importance of the other party's interests. Neither party can afford to underestimate the other's bargaining position. Individuals who are being considered for director, officer, or key employee positions possess attributes such as experience, talents, or economic resources that are highly valued by the corporation. These individuals also are likely to have other options in which to invest their resources or talents. The corporation likewise has attributes such as institutional resources and status that are attractive to prospective fiduciaries. Both parties are in positions to negotiate terms in their own best interests. Hence, their agreements, including agreements concerning corporate opportunities, are likely to reflect *both* their interests.

Their explicit agreement[36] typically is for the corporation to give a tangible compensation package (specified salary and other benefits) in exchange for the fiduciaries' satisfactory performance of designated responsibilities.[37] Fiduciaries do not ordinarily assign to the corporation 100 percent of their energies, time, efforts, and cumulative talents; they are not on call twenty-four hours a day. Corporations do not realistically expect that. Otherwise, for example, outside directors who serve in a fiduciary capacity in several corporations could not possibly fulfill their obligations.[38] Fiduciaries instead agree to utilize all the energies, time, efforts, and talents necessary to perform properly one hundred per-

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representing themselves and endowing themselves with the expansive power they need to carry out their responsibilities. Furthermore, they have no more information than other key participants. Rather than the corporation giving them access to information, they are as likely to have created or compiled that information themselves.

35. *See* Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962 (Del. 1980) (advocating the use of agency principles); Maryland Metals, Inc. v. Metzner, 282 Md. 31, 37-38, 382 A.2d 564, 568 (1978) (advocating the use of employment law principles).

36. According to one survey, 48% of the 560 largest U.S. companies have written agreements with their high-ranking employees. Stickney, *Settling the Terms of Employment*, MONEY, Dec. 1984, at 127. Information on the frequency of written employment agreements in small close corporations is unavailable, but it is probably a common practice for corporations receiving legal advice.

37. In addition to salaries, directors and executives of large, publicly-held corporations receive other benefits including stock option plans, deferred compensation, life insurance, and severance arrangements in the event of takeovers. McMillan & Bruno, *Bulls, Bears, and Bureaucrats—Major Forces Shaping Executive Compensation*, FIN. EXECUTIVE, May 1983, at 23-24. The average cash compensation that outside directors received in the largest 100 industrial corporations in 1986 was $32,924. *Id.*; HEWITT ASSOC., HIGHLIGHTS OF COMPENSATION AND BENEFITS FOR OUTSIDE DIRECTORS IN THE FORTUNE 100 INDUSTRIALS 5-6 (Sept. 1987). Information on the compensation arrangements in close corporations is not available.

38. Both part-time (outside directors) and full-time fiduciaries are multifaceted, with many roles other than the one with the corporation. They may be active in professional associations, be leaders in community and political activities, and have significant family commitments. Pursuing economic and business activities in addition to their corporate activities does not necessarily mean that they are disloyal. Without using corporate resources or time, they may develop their own investment portfolio, create and patent inventions, and write and copyright valuable publications.

Fiduciaries are even capable of serving as fiduciaries to more than one enterprise. Despite the increasing prevalence of individuals assuming multiple fiduciary roles, the corporate opportunity doctrine has not fully addressed how to resolve the resulting problems. For example, if an opportunity is deemed to belong to more than one of the corporations the fiduciary serves, the determination of which corporation has the priority right to the opportunity remains uncertain. ALI Draft, *supra*

cent of the job or function they have accepted.[39] They have not bargained away their individual skills, general experience, and ingenuity unless they have expressly agreed to do so. Fiduciaries believe that they retain the privilege to compete with the corporation in the future and to prepare for such competition while they are with the corporation. Fiduciaries certainly do not believe that they have waived all rights to opportunities in which the corporation also may have some interest.[40]

3. Increasing Number of Individuals Affected

A final reason that the individual's interest should be included in an analysis of the corporate opportunity doctrine is that the number of individuals who may be subject to the corporate opportunity doctrine is increasing. This expansion is attributable to an interaction between legal and business developments.

To begin, the number of situations implicating the corporate opportunity doctrine is increasing. Businesses are becoming more diversified and, consequently, the opportunities in which they may have some interest, expectancy, or capability are increasing. Meanwhile, fiduciaries are becoming increasingly well educated; they are multifaceted individuals who are exposed to and interested in diverse ideas and opportunities. The proliferation of professional meetings, journals for every conceivable professional specialty, and telecommunication systems allowing an extensive and instantaneous horizon of contacts and ideas enhance innovative thinking and the generation of entrepreneurial ideas. Fi-

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note 25, § 5.05(a) comment, at 111 (suggesting that fiduciaries offer the opportunity to and receive a rejection from each corporation).

In addition to the issue of conflicting loyalties, there is also the possibility that the fiduciary will be subject to differing standards of conduct. Consider an individual who is a fiduciary with a business corporation, a partnership, and a bank. An opportunity arises that may be of interest to each entity and to the individual fiduciary. While the corporate opportunity doctrine governs the fiduciary's conduct toward the corporation, the partnership opportunity doctrine and applicable banking laws govern the fiduciary's conduct toward the other entities. Thus, the fiduciary faces the difficult task of discerning what each law stipulates and, if required, to act differently with each entity. *See also* R. CLARK, CORPORATE LAW 253 & n.1 (1986) (discussing fiduciary's possible disclosure obligations to different corporations); Brudney & Clark, *supra* note 2, at 1044 (suggesting that consent, presumably of each corporation, be obtained). Note, *Opportunity Knocks*, *supra* note 12, at 258 n.26 (noting inadequacy of line of business test when there are multiple fiduciary roles); For recent cases on the partnership opportunity doctrine, see Mathis v. Meyeres, 574 P.2d 447 (Alaska 1978); Dixon v. Trinity Joint Venture, 49 Md. App. 379, 431 A.2d 1364 (1981). For recent cases discussing the fiduciary standards regarding "corporate" opportunities imposed on directors of financial institutions, see United States v. Chenaur, 552 F.2d 294 (9th Cir. 1977); First Nat'l Bank of La Marque, Tex. v. Smith, 436 F. Supp. 824 (S.D. Tex. 1977), *aff'd in part and vacated in part*, 610 F.2d 1258 (5th Cir. 1980); Valiquet v. First Fed. Sav. & Loan Ass'n, 87 Ill. App. 3d 195, 408 N.E.2d 921 (1979); Warren v. Century Bankcorp., 744 P.2d 846 (Okla. 1987). *See also* 12 C.F.R. §§ 555.17, 571.9 (1988) (regulations governing usurpation of corporate opportunities of federal savings and loan institutions).

39. Depending on the job duties, the satisfactory performance of one's professional responsibilities may require 100% of one's total energies, time, and talent. This is the rare case, however, and is presumably an arrangement voluntarily and knowingly entered into by the fiduciaries.

40. "Is it necessary, considering all the circumstances, to impose a disability upon officers in the position of the defendant to secure a proper performance of their function within the corporate business?" Note, *Fiduciary Duty of Officers and Directors Not to Compete With the Corporation*, 54 HARV. L. REV. 1191, 1195 (1941).

nally, the fast pace of technological development and the increasing concern with industrial productivity provide fertile ground for more opportunities.

In part because of these developments, businesses have moved away from traditional management structures in which a few clearly designated individuals make all the important decisions. In these traditional structures, it was indisputable who the directors and officers were and hence who was subject to fiduciary duties such as those imposed by the corporate opportunity doctrine. Today individuals on various management levels have access to confidential information and possess significant decision making authority. Given these circumstances, it is not surprising that the courts have not resolved fully either who is subject to the doctrine or how that determination will be made.

Clearly, as a result of these business and management developments, the categories of individuals potentially subject to the doctrine are expanding. For example, various courts have found key employees[41] and majority shareholders[42] subject to the doctrine. Several cases decided in Georgia illustrate the difficulty of these issues. In determining whether a chief engineer was subject to the state's business opportunity statute, the supreme court concluded that the law was applicable to directors and officers but not to "typical employees."[43] It implied, however, that individuals other than directors and officers might be subject to the law if they were in fiduciary positions. The court did not elaborate on what constituted fiduciary status.[44] A later Georgia case held that the statute should be read literally to apply only to directors and officers.[45] The holding, however, was expansive in its application. A vice-president of sales, in the absence of evidence to the contrary, was presumed to be an "officer" and hence subject to the statute.[46]

41. *See* Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962 (Del. 1980); Wilmington Trust Co. v. Consistent Asset Management Co., No. 8867 (Del. Ch. March 25, 1987) (LEXIS, States library, Omni file); Maryland Metals, Inc. v. Metzner, 282 Md. 31, 39-40, 382 A.2d 564, 568-69 (1978) (court did permit employee certain preparation privileges while he was contemplating a different job).

42. *See* Banks v. Bryant, 497 So. 2d 460, 465 (Ala. 1986) (per curiam); Schreiber v. Bryan, 396 A.2d 512, 519-20 (Del. Ch. 1978).

43. Southeast Consultants, Inc. v. McCrary Eng'g Corp., 246 Ga. 503, 506, 273 S.E.2d 112, 116 (1980).

44. *Id.*; Walter E. Zemitzsch, Inc. v. Harrison, 712 S.W.2d 418, 422 (Mo. App. 1986) (defendant was not a fiduciary subject to the doctrine because he did not have access to confidential information and had limited authority).

45. Sofate of Am., Inc. v. Brown, 171 Ga. App. 39, 39-42, 318 S.E.2d 771, 775 (1984). That court suggested that courts look to the corporate minutes to determine who are the officers. *Id.* at 42, 318 S.E.2d at 776. This indicates that directors may determine who the fiduciaries are merely by designating these individuals in the minutes as corporate officers.

46. The American Law Institute (ALI) has proposed definitional guidelines for determining who is subject to the doctrine. In addition to the traditional fiduciary roles of directors and officers designated under state corporate law statutes, the guidelines include the chief operating officers, heads of principal units or functions, and those performing a major policy making function. ALI Draft, *supra* note 25, §§ 1.22(a)-(b), 1.28, 5.05(a), 5.12 (regarding dominating shareholders). While useful as a beginning, these guidelines may be difficult to apply to small, informal close corporations. In that setting there are often numerous "bosses" and few typical employees, and formal and accurate designations of authority are infrequent. *E.g.*, Tulumello v. W.J. Taylor Int'l Const. Co., 84 A.D.2d 903, 903, 446 N.Y.S.2d 673, 697 (1981) (employee had an officer's title, but the court decided his fiduciary status was in name only and hence he was not subject to the doctrine); Lowder v. All Star Mills, Inc., 82 N.C. App. 470, 472, 346 S.E.2d 695, 697 (1986) (defendant did not have a

The extension of the corporate opportunity doctrine to nontraditional fiduciaries raises several issues. First, courts are more likely to conclude that key employees are subject to the doctrine and its restrictions if those employees have been endowed with more trust and responsibility (as suggested by access to confidential information and increased authority) and have invested significantly in the corporation (as suggested by their years with the corporation and an equity interest). Given this judicial propensity and a desire to avoid restrictions on their activities, employees may be hesitant to accept more trustworthy positions or to increase their corporate commitment. This result seems contrary to policy interests, which would be better served if individuals were rewarded rather than penalized for their increasing corporate roles and responsibilities.

Second, the evolving distinction between key employees who are considered fiduciaries and those who are not creates uncertainty for individuals with major corporate responsibilities. Many of these individuals are no doubt unaware that they may be subject to the corporate opportunity doctrine. This lack of notice is especially significant because of the disparity between the standard of conduct for nonfiduciaries and the standard for fiduciaries.[47] In light of the potential consequences for key employees, corporations arguably should have a duty to inform those employees when the corporation considers them to be fiduciaries subject to the corporate opportunity doctrine.

C. *Societal Interest*

The outcome of corporate opportunity disputes may influence important societal goals including the goals of creating new businesses, of promoting competition, and of enhancing the freedom to contract.[48] The prior discussion of

formal title but was nonetheless considered a de facto officer). A similar problem arises under § 16 of the Securities Exchange Act of 1934; courts have struggled with the definition of who is an "officer" under that statute. *E.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston, 566 F.2d 1119, 1122 (9th Cir. 1978); Schimmel v. Goldman, 57 F.R.D. 481, 485-86 (S.D.N.Y. 1973).

47. If individuals are considered mere agents, they are prohibited under general agency principles only from pursuing opportunities that are within the scope of their agency. Clark, *supra* note 34, at 68-71. They may pursue opportunities outside this scope, even if that results in their competiting with the corporation. Levy & Surrick v. Surrick, 362 Pa. Super. 510, 524 A.2d 993, 995 (1987), *allocatur denied*, 538 A.2d 877 (1988); *see also Clark, supra* note 34, at 68-72 (discussion of agency principles). If the individuals are considered typical nonfiduciary employees, courts may permit them to compete with their former corporation as long as they have not executed noncompetition covenants. *See infra* note 304; *see also* ALI Draft, *supra* note 25, § 5.05(b) comment illus. 4 (higher standard regarding inventions for certain fiduciaries than for other employees).

48. The possibility of corporate opportunity prosecution may preclude fiduciaries from culminating or implementing agreements with a third party, even though the third party refuses to pursue the opportunity with the corporation. Thus, the application of the corporate opportunity doctrine may impinge not only on the fiduciaries' but also on the third party's freedom to contract. This result may occur even if the fiduciaries' preclusion from participating violates the fiduciaries' binding obligation under the agreement with the third party. *See, e.g.*, Lindenhurst Drugs, Inc. v. Becker, 154 Ill. App. 3d 61, 71, 506 N.E.2d 645, 652 (1987) (court ordered accounting of profits by fiduciaries in outside venture to be held in constructive trust for corporation); Comedy Cottage, Inc. v. Berk, 145 Ill. App. 3d 355, 362, 495 N.E.2d 1006, 1012 (1986) (upheld injunction against fudiciary's lease with third party on grounds the lease interfered with the corporation's interest in a lease renewal); Energy Resources Corp., v. Porter, 14 Mass. App. Ct. 296, 300-02, 438 N.E.2d 391, 394-95 (1982) (fiduciary owes damages to the corporation even though grant money already paid to fiduciary by United States Department of Energy).

individual interests reveals how the outcome of corporate opportunity cases may effectively preclude fiduciaries from developing competing businesses. Spin-off businesses from close corporations in diverse industries appear to suffer special harm.[49] This restraint on individuals' freedom to compete is contrary to society's long-standing goal of promoting competition.

Moreover, the right to start a new business based on an innovative product, a new management approach, or an unmet market niche is an integral part of our capitalist system. The promotion of entrepreneurship is justified considering the contributions it has made to this country. Over the last two decades, small and medium sized companies created more new jobs than any other sector in the economy, serving as the largest source of economic growth.[50] While many new businesses are not based on a technological innovation, much technological innovation has come from new firms.[51] Furthermore, the importance of entrepreneurship promises to increase in the future. Both academia and government recognize the role of entrepreneurship in enhancing American competitiveness in the global economy.[52]

Despite the importance of entrepreneurship, the corporate opportunity doctrine does not explicitly take it into account. This omission is explained in part by a lack of understanding of how the results in corporate opportunity cases and entrepreneurship are related. The following section discusses how these results may (1) decrease the number of business opportunities that are successfully developed and (2) systematically discourage fiduciaries' entrepreneurial instincts.

1. Successful Development of Opportunities

If outcomes of corporate opportunity lawsuits generally deny opportunities to fiduciaries,[53] the number of entrepreneurial ventures that succeed will decrease because fiduciaries as a class arguably have a higher probability of successfully exploiting opportunities than others who may seek to develop the opportunities.[54] For instance, fiduciaries have a higher probability of success-

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49. *See supra* note 2.

50. D. BIRCH, *supra* note 6, 6-16 (substantiating that the formation and expansion of firms with fewer than 20 individuals have created virtually all U.S. net employment gains since 1981); P. DRUCKER, INNOVATION AND ENTREPRENEURSHIP 1-11 (1985); *see* P. STONEMAN, THE ECONOMIC ANALYSIS OF TECHNOLOGICAL CHANGE 24-25 (1983).

51. Spanner, *Trade Secrets Versus Technological Innovation*, TECH. REV., Feb. 1984, at 12.

52. Executive Order No. 12,591, 3 C.F.R. 220 (1987) (implementing Federal Technology Transfer Act of 1986, Pub. L. No. 99-502, 100 Stat. 1785 (1985)) (creators of technology may elect to retain title to government-funded inventions); P. Jones & D. Treece, *Research Agenda on Competitiveness: A Program of Research for the Nation's Business Schools* (Internat'l Bus. Working Paper No. 1B-7, April 1987, Berkeley Business School).

53. Denial of the corporate opportunity to fiduciaries is not an improbable outcome. Some commentators argue for a rule categorically denying opportunities to certain fiduciaries. Brudney & Clark, *supra* note 2, at 1023. In addition, courts denied the corporate opportunity to approximately 50% of the defendants in the cases surveyed in the author's research.

54. In addition, precluding fiduciaries from exploiting opportunities will decrease the absolute number of opportunities developed. At first glance, one might assume that all attractive opportunities that are denied to fiduciaries will be exploited by either the corporation or random third parties. Although they may not be as successful at developing the opportunities as fiduciaries, there will at least be attempts to exploit these opportunities. The denial of the opportunities to fiduciaries, however, could result in a certain number of opportunities simply going untapped. For example, the

fully developing the opportunity than random third parties.[55] Individuals generally become fiduciaries because of their past business successes. Their current fiduciary positions suggest that they have the personal attributes, incentives, skills, and experiences to increase the probability of achieving another business success.[56] Furthermore, fiduciaries often pursue opportunities in the same industry or directed toward the same target market, applying their cumulative business acumen to the new opportunity and thereby increasing its probability of success. Random third parties do not have the same advantages.

Assuming that both the corporation and the fiduciaries have adequate financial resources to pursue the opportunity, fiduciaries, in certain circumstances, have a higher probability of successfully developing the opportunity than the corporation. This likelihood is particularly true if the opportunity deals with a product or market innovation. Bringing an innovation from the idea stage to successful commercialization is a long, arduous, and risky process.[57] Evidence suggests that an individual's more flexible start-up operations can manage the process more effectively than a more structured corporation.[58]

The established corporation has standardized procedures, policies, and a corporate bureaucracy that impede accommodation of the novel problems inevitable in the entrepreneurial process. The corporation's tendency is to make the new opportunity fit existing operations. In addition, the corporation's attempt to accommodate the entrepreneurial process may significantly disrupt the ongoing operations. The more unrelated the opportunity is to the corporation's current product lines and business activities, the less likely the corporation will be able to exploit successfully the idea.[59] In contrast, fiduciaries create start-up operations to develop the innovative idea; they have no established bureaucracy. Their management is flexible because they do not yet follow established policies for committing their resources. They can therefore accommodate the changing demands of a developing product and tailor optimal solutions from a broader

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particular fiduciaries might have a particular competitive advantage, such as unique skills or expertise, that would make an opportunity profitable for the fiduciaries but not for others. Or the fiduciaries may originate an idea that others could exploit, but the fiduciaries do not disclose it to anyone else. Even if courts would deem an opportunity belongs to the corporation, the corporation may decide not to exploit it. The corporation, for example, may not have the capability for exploitation or the opportunity is not compatible with its current policy and strategy. The corporation may keep the idea confidential, even though it will not exploit the opportunity, thereby preventing a third party, such as a competitor, from learning of and developing it.

55. Current fiduciaries would have fewer advantages over past fiduciaries of the corporation or fiduciaries of other corporations in the same industry. Only a limited number of individuals, however, would have both comparable expertise in the particular industry or market *and* a desire to pursue a given opportunity.

56. The best predictor of future business success is past business success. Owens, *Background Data* in HANDBOOK OF INDUSTRIAL AND ORGANIZATIONAL PSYCHOLOGY 609, 640 (M. Dunnette ed. 1976). This prediction assumes that fiduciaries receive their fiduciary positions on the basis of professional achievements and talents. If this is not the case, if for instance fiduciaries received their positions because of family affiliation, then their current fiduciary status may not be as predictive of future success.

57. E. MANSFIELD, THE ECONOMICS OF TECHNOLOGICAL CHANGE 99-133 (1968).

58. P. DRUCKER, *supra* note 50, at 141-206.

59. *See generally* Williams, Paez & Sanders, *Conglomerates Revisited*, STRATEGIC MGMT. J., Sept.-Oct. 1988, at 403 (documenting trend of conglomerates to divest unrelated businesses because diversification was unsuccessful).

range of options.[60]

2. Development of Entrepreneurial Instincts

Economists have long recognized the critical role that the entrepreneurial element plays in commercial activities.[61] Individuals with entrepreneurial instincts and skills are alert to information and experiences, and consequently see opportunities that others do not notice. By questioning current perceptions and using a keen sense of discovery, these individuals recognize ways in which resources can be shifted from low productivity to high productivity. Fiduciaries' exposure to critical information, their business background, and their broader corporate perspective provide fertile ground for the cultivation of their entrepreneurial instincts.

The corporation reasonably expects its fiduciaries to be alert to entrepreneurial opportunities on the corporation's behalf. This expectation may be an explicit or implicit part of their employment arrangement. Some entrepreneurial opportunities, however, arguably are outside the corporation's sole prerogative. A judicial tendency to deny corporate opportunities to fiduciaries who have legitimate claims to these opportunities would gradually discourage fiduciaries from cultivating entrepreneurial instincts and skills in general. Consequently, opportunities that might have led to great benefit for corporations and society would go unnoticed by fiduciaries who have not developed sensitivity to potential opportunities.[62]

These negative consequences require consideration in light of both the corporation's and the fiduciaries' rights.[63] Opportunities clearly belonging to the corporation should not be given to fiduciaries as a form of management compensation.[64] Opportunities to which both the fiduciaries and the corporation have legitimate interests, however, should not be deemed automatically to belong to the corporation. A satisfactory corporate opportunity doctrine must recognize and accommodate the competing interests of fiduciaries and corporations, in or-

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60. A hypothetical case illustrates how one entrepreneur consciously managed his company to create employee commitment and trust. G. SHEA, COMPANY LOYALTY: EARNING IT, KEEPING IT 37-41, 44 (1987).

61. *See* P. DRUCKER, *supra* note 50, at 31-75; I. KIRZNER, COMPETITION AND ENTREPRENEURSHIP 31-74 (1973); E. MANSFIELD, *supra* note 57, at 27.

62. In addition, individuals may decline fiduciary roles altogether rather than forsake the possibility of entrepreneurial ventures. *See also supra* text accompanying notes 46-47 (discussing how applying doctrine to nontraditional fiduciaries may discourage key employees from accepting fiduciary positions).

63. Discouragement of entrepreneurial activities imposes an additional societal cost. Studies have indicated that individuals' entrepreneurial activities, such as information gathering and networking experiences outside the corporation, lead to a diffusion and a cross pollination of innovative ideas. This, in turn, may lead to technological breakthroughs of enormous importance. E. MANSFIELD, *supra* note 57, at 110-30; Ettlie, *The Impact of Interorganizational Manpower Flows on the Innovative Process*, MGMT. SCI., Sept. 1985, at 1055, 1055-71. Some of these breakthroughs may never occur, however, if fiduciaries do not have the incentive to engage in these entrepreneurial activities.

64. This conclusion is consistent with the conclusion that the use of inside information for personal advantage should not be viewed as part of management's compensation. Dirks v. SEC, 463 U.S. 646, 653 n.10 (1983); *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 n.15 (1961).

der to serve successfully the societal goals of enhancing competition and promoting entrepreneurship.

III. Traditional Tests Revisited

The prior section substantiated that corporate opportunity cases trigger not only corporate interests, but also legitimate individual and societal interests. The following review of traditional corporate opportunity tests[65] confirms that these tests do not adequately acknowledge noncorporate interests.

While the tests are predicated on a single concern—the protection of the corporate interest—a survey of the tests discloses diverse approaches serving that concern. The tests discussed here and summarized in Table 1, are the line of business test, the expectancy test, the fairness test, and the *Miller* two-step test.[66] The following discussion elaborates on the landmark cases, their key inquiries, and the ways in which they consider various factors. Variations among the tests are attributable in part to the different presumptions the courts make about the human nature of fiduciaries. These, in turn, shape their determination of how restrictive the limitations on fiduciaries' activities should be.

A. *Line of Business Test*

The most cited and prominent case in the corporate opportunity area is *Guth v. Loft, Inc.*[67] In *Guth* the Delaware Supreme Court tied the principle that corporate fiduciaries are analogous to trustees to the presumption that fiduciaries are inclined to place their desires for personal gain above their fiduciary loyalty to the corporation.[68] Relying on these premises, the court fashioned a

65. Other articles and sources discuss the different tests at length. *See, e.g.*, R. CLARK, *supra* note 38, at 223; Brudney & Clark, *supra* note 2; Note, *Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities, or Engaging in a Competing Business*, 39 COLUM. L. REV. 219 (1939) [hereinafter Note, *Liability*]; Note, *The Tests of Corporate Opportunity*, 8 CUMB. L. REV. 942 (1978); Note, *Corporate Opportunity in the Close Corporation—A Different Result?*, 56 GEO. L.J. 381 (1967); Note, *Corporate Opportunity*, 74 HARV. L. REV. 765 (1961); Note, *Corporate Competition*, *supra* note 12; Note, *Opportunity Knocks*, *supra* note 12.

66. The test described in Solimine v. Hollander, 128 N.J. Eq. 228, 16 A.2d 203 (1940), is also cited as a separate test, although the *Solimine* court viewed its guidelines as a mere rearticulation of *Guth v. Loft*, 23 Del. Ch. 225, 5 A.2d 503 (1939), and existing case law. *Solimine*, 128 N.J. Eq. at 245, 16 A.2d at 215. The *Solimine* court concluded that the existence of any one of the following factors precluded a finding that the opportunity belonged to the corporation: the fiduciaries' exercised good faith, the corporation was unable to develop the opportunity, the opportunity was not essential to the corporation, the fiduciaries did not use corporate resources, or the fiduciaries were not competing with the corporation. *Id.* The *Solimine* test is a very lenient test of the fiduciaries' conduct and yields a narrow range of opportunities that presumptively belong to the corporation. No case in the last decade has explicitly followed *Solimine.*

67. 23 Del. Ch. 225, 5 A.2d 503 (1939). *Guth v. Loft* has been cited 225 times in Lexis as of October 1988. Other landmark cases in this area of the law have been cited much less frequently. *E.g.*, Durfee v. Durfee & Canning, Inc., 323 Mass. 187, 80 N.E.2d 522 (1948) (58 times); Solimine v. Hollander, 128 N.J. Eq. 228, 16 A.2d 203 (1940) (43 times); Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496, 28 So. 199 (1900) (28 times); Miller v. Miller, 301 Minn. 207, 222 N.W.2d 71 (1974) (17 times).

68. *Guth*, 23 Del. Ch. at 270, 5 A.2d at 510. The court in *Guth* stated:

> A public policy, existing through the years, and derived from a *profound knowledge of human characteristics and motives*, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty,

test and remedy which, if strictly and faithfully adhered to, would virtually preclude fiduciaries from pursuing any business activities on their own.[69] Charles Guth was the president and dominant director of Loft, Inc., a corporation whose primary business was the manufacture of candy and soft drinks that it retailed through its own chain of regional stores.[70] While investigating possible suppliers for its soft drink syrup, Guth considered a fledgling cola syrup company. The principal of that company, who owned a secret formula for a cola syrup but had no money, offered to sell the business to Guth. Extensively using Loft resources, including loans, facilities, and personnel, Guth personally acquired and developed the company that subsequently became the Pepsi-Cola Company.[71]

In determining whether Guth's acquisition and development of Pepsi-Cola usurped an opportunity belonging to Loft,[72] the court delineated a variety of factors.[73] While it noted these various factors, the *Guth* court, and other courts citing *Guth*, singled out the "line of business" analysis as the preeminent test.

> The real issue is whether the opportunity to secure a very substantial stock interest in a corporation to be formed for the purpose of exploiting a cola beverage on a wholesale scale was *so closely associated with*

> not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.

Id. (emphasis added). The traditional remedy of a constructive trust also is consistent with the trustee analogy and the presumption of the fiduciaries' predispositions:

> 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.

Id. (emphasis added).

69. The test used in Irving Trust Co. v. Deutsch, 73 F.2d 121, 124 (2d Cir. 1934), *cert. denied*, 294 U.S. 708 (1935), imposes on fiduciaries the strictest standard of the tests considered here by essentially prohibiting fiduciaries from all opportunities.

70. *Guth*, 23 Del. Ch. at 258-61, 5 A.2d at 509-12. The court did not explain its conclusion that Guth was able to dominate the corporation. He apparently owned no shares and joined the corporation as vice president only two years before he developed the contested opportunity.

71. *Id.* at 259-64, 5 A.2d at 505-08.

72. After the Pepsi-Cola acquisition, Guth served as a fiduciary to at least three corporations. *Id.* at 258, 5 A.2d at 505. These multiple fiduciary roles raise a number of questions regarding which corporation, if any, had a priority interest in the opportunity. For instance, Grace, like Pepsi-Cola, manufactured soft drink syrups, so the opportunity was actually closer to its line of business than to Loft's. *Id.* at 259, 5 A.2d at 506. Would this entitle Grace to a priority interest, or would it eliminate both corporations' claims to the opportunity? *Id.* at 273-81, 5 A.2d at 506. Would Grace's insolvency eliminate any claim it might have to the opportunity? For further discussion on multiple fiduciary roles, see *supra* note 38.

73. *Guth*, 23 Del. Ch. at 273-81, 5 A.2d at 511-15. An opportunity did not belong to the corporation if it was acquired in the fiduciaries' individual capacities and without the use of corporate resources or if it was not essential to the corporation, or if it was one in which the corporation did not have an interest or expectancy. *Id.* at 271, 5 A.2d at 510. On the other hand, an opportunity did belong to the corporation if it was one in which the corporation had an interest or expectancy, was in the corporation's "line of business" and of practical advantage to it, and was one that the corporation was financially able to exploit. *Id.* at 272, 5 A.2d at 511. *Guth* defined "expectancy" more broadly than the traditional test in *Lagarde*, discussed *infra* text accompanying notes 83-91. Under *Guth*, an existing property right to the opportunity was not necessary. Loft had a protectable expectancy because it had a "practical and essential" interest in obtaining a satisfactory supply of cola syrup. *Guth*, 23 Del Ch. at 280, 5 A.2d at 514.

TABLE 1. TRADITIONAL TESTS: CORPORATE INTEREST AS EXCLUSIVE CONCERN

Test	Key Inquiries	Consequences
Line of Business Test	Is the opportunity in competition with corporation? Is the opportunity one to which the corporation could possibly adapt its resources?	If yes, the fiduciaries are precluded from pursuing the opportunity.
Expectancy Test	Does the corporation have a contractual claim to the opportunity?	If yes, the fiduciaries are precluded from pursuing the opportunity.
Fairness Test	Would it be unfair to the corporation for the fiduciaries to pursue the opportunity?	If yes, the fiduciaries are precluded from pursuing the opportunity.
Miller Test	Is the opportunity in the corporation's line of business? If so, would it be unfair to the corporation for the fiduciaries to pursue the opportunity? (Combination of line of business test and fairness test).	If both in the line of business and unfair, the fiduciaries are precluded from the opportunity.

the existing business activities of Loft, and so essential thereto, as to bring the transaction within that class of cases where the acquisition of the property would throw the corporate officer purchasing it *into competition* with his company. This is a factual question to be decided by reasonable inferences from objective facts.[74]

Applying this test, the court determined that the Pepsi-Cola opportunity was so closely associated and essential to Loft that Guth would effectively become a

74. *Id.* at 275, 5 A.2d at 513 (emphasis added). The court found the following factors relevant. First, Guth received the opportunity in his corporate capacity. *Id.* The court reached this conclusion because the opportunity became available to Guth because of his control of Loft, not because of his individual position or personal resources. *Id.* at 276-77, 5 A.2d at 512-13. He also investigated Pepsi-Cola originally as a possible supplier for Loft and subsequently learned of its availability as an acquisition. Second, he extensively used corporate resources. *Id.* at 282, 5 A.2d at 515. Third, although the corporation had no property right, the opportunity was of practical concern. *Id.* at 280, 5 A.2d at 514. It provided an essential commodity that was available only from a limited number of sources. *Id.* at 280-82, 5 A.2d at 512-15.

In addition, the court clearly thought Guth acted egregiously and in bad faith, saying his actions were "gross violations of legal and moral duties" and that "[c]unning and craft supplanted sincerity. Frankness gave way to concealment . . . . A genius in his line he may be, but the law makes no distinction between the wrong-doing genius and the one less endowed." *Id.* at 282, 5 A.2d at 515.

For further cases using the line of business test, see Annotation, *What Business Opportunities are in "Line of Business" of Corporation for Purposes of Determining Whether A Corporate Opportunity was Presented,* 77 A.L.R.3D 961 (1977); Note, *Opportunity Knocks, supra* note 12, at 257-58.

competitor via Pepsi-Cola.[75]

The court's conclusion that Pepsi-Cola would be a competitor merits further analysis. Although it did have limited wholesale activities, Loft was essentially a regional retailer of candies and soft drinks.[76] There was no indication that it intended or desired to diversify into manufacturing cola syrup. The corporation was actively investigating alternative suppliers;[77] therefore one might reasonably infer that its corporate strategy did not include such an expansion. Because Pepsi-Cola envisioned being a nationwide wholesaler of cola syrup, it was not a direct competitor. Loft's acquisition of Pepsi-Cola would most accurately be described as the acquisition of a supplier.[78]

Although the court described the line of business test as one that would preclude the fiduciaries from pursuing an opportunity that would compete with the corporation, the court's application of the test precludes fiduciaries from taking any opportunity to which the corporation can adapt its resources. The court determined that Pepsi-Cola and Loft were in the same line of business because Loft's plant, equipment, executives, personnel, and finances could have been adequately adapted to develop the Pepsi-Cola opportunity.[79] The wholesale and retail operations for soft drinks utilize different outputs and inputs, production facilities, and distribution channels. Despite these differences, with sufficient financial resources Loft could have adapted to this or virtually any other diversification. Thus, under the *Guth* court's adaptability test, virtually all opportunities presumptively belong to the corporation.

If courts interpret the line of business test to preclude only immediately competitive opportunities, then the test in theory is less expansive than if it is interpreted to preclude opportunities that may be feasible after corporate adaptation. Many contested opportunities, however, are competitive to the corporation.[80] Hence, in practice, either the adaptability test or the competitiveness test would reach the same result. Courts will find the fiduciaries breached their duties, and the cumulative effect will be that fiduciaries will routinely lose corporate opportunity cases.[81]

This result affects societal and individual interests. Next to an absolute prohibition against fiduciaries' pursuit of any opportunities, the test's prohibition against fiduciaries' pursuit of any *competing* opportunities is the most likely to restrain competition in the marketplace and to infringe upon individuals' free-

75. *Guth*, 23 Del. Ch. at 281, 5 A.2d at 515.

76. Its wholesale activities in 1931 amounted to $800,000. The corporation's assets exceeded $9,000,000. *Id.* at 258, 278, 5 A.2d at 505, 514.

77. *Id.* at 258, 5 A.2d at 505.

78. When Guth argued that the opportunity was not in Loft's line of business, the court noted that Loft's wholesale activities were not "unimportant" and that "latitude should be allowed for the development and expansion" of the corporate activities. *Id.* at 279-80, 5 A.2d at 514.

79. *Id.* at 280, 5 A.2d at 514. It was also concerned that Loft, because of its domination by Guth, would be a captive purchaser of Pepsi-Cola.

80. *See supra* note 2.

81. *E.g.*, Lindenhurst Drugs, Inc. v. Becker, 154 Ill. App. 3d 61, 506 N.E. 645 (1987); Strangeburg v. Allied Distrib. & Bldg. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file); Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358 (Tex. Ct. App. 1986).

dom to start their own businesses. Despite these consequences, the line of business test neither acknowledges any noncorporate interests nor considers the reasonable expectations of the parties. For example, prior to and during his employment with Loft, Guth and his family owned the Grace Company.[82] Grace supplied Loft and other retailers with chocolate syrup for soft drinks. Although Grace and Pepsi-Cola had similar businesses, each having the potential for analogous corporate opportunity violations, the corporation apparently did not object to Guth's involvement with Grace. Guth, therefore, may have reasonably assumed that the corporation would have no objection to the Pepsi-Cola acquisition. The line of business test as articulated in *Guth*, however, did not accommodate this relevant factor.

B. *Expectancy Test*

An earlier case, *Lagarde v. Anniston Lime & Stone Co.*,[83] discussed another traditional corporate opportunity test. It based the fiduciaries' duty on agency principles rather than on the trustee standards controlling in *Guth*.[84] The court took a much more limited view of what presumptively belongs to the corporation and, consequently, the range of opportunities closed to fiduciaries:[85] "Good 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 subjects of their trust or duty."[86]

In *Lagarde* a family business engaged in quarrying and manufacturing limestone was interested in acquiring a parcel of land endowed with valuable limestone deposits. The corporation acquired an undivided one-third interest in the land. In addition the corporation had a contractual commitment to lease and buy the second undivided one-third interest and had tried to negotiate at various times the purchase of the remaining one-third interest. Despite these prior dealings, two of the three principals of the corporation personally purchased the two outstanding one-third interests in the property.[87]

In determining whether the fiduciaries had breached their duties, the court stated that an opportunity belonged to the corporation only if the opportunity is one in which the corporation had an existing interest or an expectancy growing from an existing interest, or if the fiduciaries' activities would "balk the corporation in effecting the purposes of its creation."[88] If none of the above circumstances exist, the fiduciaries' duty does not arise. Other circumstances, such as whether the individuals learned of the opportunity in their corporate or personal capacities, were not relevant.[89]

82. *Guth*, 23 Del. Ch. at 258, 5 A.2d at 505.
83. 126 Ala. 496, 28 So. 199 (1900).
84. *Id.* at 500-01, 28 So. at 201.
85. *Id.* at 502, 28 So. at 202.
86. *Id.*
87. The principals used a second corporation and an agent. *Id.* at 498, 28 So. at 200.
88. *Id.* at 502, 28 So. at 201.
89. *Id.*

The court interpreted a corporation's protectable interest as one based on a contractual claim. Hence the one-third interest to which the corporation had a contractual commitment to buy and lease was a protectable interest, while the one-third interest to which the corporation had no contractual commitment was not protectable. "No expectancy of value springs from the alleged fact the complainant 'has been negotiating for and endeavoring to purchase' that interest at divers [sic] undesignated times."[90] "Balking" the corporation clearly is intended to be narrowly limited to those activities that conflict with the very purpose for which the corporation and was formed.[91] The court did not extend the purpose of the corporation to include anticipated or speculative business activities.

Thus, this test would carve out for the corporation only those opportunities for which it actually has a contract. By nature, these are opportunities of which the corporation has knowledge, was or is actually pursuing, and to which the corporation is reciprocally legally committed. Because this describes a comparatively narrow range of opportunities, fiduciaries subject to this test would be in a more favorable litigation position than those fiduciaries subject to the line of business test.[92]

Like the line of business test, the expectancy test does not explicitly consider societal and individual interests. In contrast to the line of business test, however, the expectancy test, by allowing the fiduciaries' pursuit of any opportunities except those to which the corporation has a contractual claim, is minimally intrusive on the fiduciaries' right to start a competing business. In fact, even without the expectancy test, fiduciaries probably could not pursue opportunities to which the corporation already had a contractual claim since, by doing so, the fiduciaries would be interfering with the presumably binding contractual relations between the corporation and its contracting party.

Even though the expectancy test may operate to foster competition, as in *Lagarde*, its results are not reliable because of its failure to consider the crucial relevant interests. The test's consideration of how the *corporation* would expect to resolve a corporate opportunity dispute is reasonable and important. The approach suggests that the *Lagarde* court wanted to resolve the dispute in a realistic context. The court however, does not, consider how the *fiduciaries* would expect to resolve the dispute. The court did not consider the fiduciaries' prior dealings or agreements with the corporation, the customs of the industry, or any other factors which could indicate the fiduciaries' expectations of how the dispute should be resolved. Because it ignores the fiduciaries' expectations, the *Lagarde* court's analysis of the corporate-fiduciary relationship is incomplete.[93]

90. *Id.*

91. Examples include the right of way in the path of the projected route of a railroad company, or the patent rights to the work that was the purpose of a corporation's creation. *Id.* at 502, 28 So. at 201-02.

92. In Georgia the courts have adopted a model based on *Lagarde*'s expectancy test, and the cases decided under that test illustrate that test's favorability to fiduciaries. *See infra* text accompanying notes 195-223.

93. In light of the court's limited perspective, its determination that the corporation's expectations are limited to contractually based opportunities is surprising. One would have predicted that

A final problem with *Lagarde*'s expectancy test is that it does not promote the integrity of the corporate-fiduciary relationship. It puts fiduciaries in a potentially compromising position. If they are precluded only from opportunities on which the corporation has a contract, they may be tempted to exercise less than their best efforts to obtain the contract for the corporation. By exerting less than their best efforts, they may increase the probability that the corporation does not culminate a contract. Under *Lagarde*'s test, the absence of a corporate contract would then allow the fiduciaries to pursue the opportunity without fear of liability.

C. *Fairness Test*

The traditional corporate opportunity test of fairness was announced in *Durfee v. Durfee & Canning, Inc.*[94] The *Durfee* court stated:

> [T]he true basis of the governing doctrine rests fundamentally on the unfairness in the particular circumstances of a director, whose relation to the corporation is fiduciary, "taking advantage of an opportunity [for his personal profit] when the interest of the corporation justly calls for protection. This calls for the application of ethical standards of what is fair and equitable . . . [in] particular sets of facts.[95]

The court offered no specific guidelines on what constitutes fairness. It suggested only that defendant's use of corporate resources, the corporation's financial inability to develop the opportunity, and the corporation's acquiescence after sufficient disclosure of the fiduciary's exploitation of the opportunity may have been relevant factors.[96]

Ballantine on Corporations, credited by the *Durfee* court for its fairness test, does cite various factors. First are factors generally regarding the relationship between the opportunity and the corporation, 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. Second are factors generally regarding the relationship between the fiduciaries and the opportunity, including 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.[97] The fairness test does

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the court would interpret the corporation's expectation to include a broader range of opportunities. Thus, the court not only ignored the fiduciaries' expectations, but inaccurately assessed the corporation's expectations. A realistic projection of the corporation's and fiduciaries' reasonable expectations would indicate that the corporation should have a legitimate claim to more than contractually-based opportunities.

94. 323 Mass. 187, 80 N.E.2d 522 (1948).

95. *Id.* at 199, 80 N.E.2d at 529 (citing BALLANTINE ON CORPORATIONS 204-05 (rev. ed. 1946)).

96. *Id* at 200, 202, 80 N.E.2d at 529, 531.

97. BALLANTINE, *supra* note 95, at 206; *see* R. CLARK, *supra* note 38, at 228; Annotation,

not elevate any particular factor to a preeminent position, but rather weighs the factors on a case-by-case basis on an ideal but unarticulated equitable scale.

The problem with the fairness test is that it is too vague and thus provides no predictable guidelines on which fiduciaries and corporations may base their conduct. While courts can use the test's various equitable considerations to shape a decision on a case-by-case basis, the test does not offer preventive guidelines. In addition, the test studies the fiduciaries' conduct only to determine if the corporation has been unfairly harmed. It does not consider what is fair to the fiduciaries or society.

D. *Miller Two-Step Test*

The test introduced in *Miller v. Miller*[98] is on its face merely the combination of the line of business test and the fairness test into a sequential two-step process. It is, however, distinguishable from the other tests in its analytical approach to the determination of liability and in its implicit consideration of the fiduciaries' interests.

In *Miller* a minority shareholder of a family business sued his two brothers. Defendants were the active managers of Miller Waste, a corporation that manufactured waste wiping cloths for industrial use.[99] Defendant brothers and their wives personally established and developed five businesses separate from the original corporation over the span of a decade. Several of these businesses prospered to multi-million dollar enterprises. In determining whether the defendants were liable to the original corporation for establishing the other businesses, the court considered the threshold issue of whether the opportunity belonged to the corporation.[100] Using a flexible application of *Guth*'s line of business test, the court stated that if the opportunity "bears no logical or reasonable relation to the existing or prospective business activities of the corporation or [if the corporation] lacks either the financial or fundamental practical or technical ability to pursue it, then such opportunity would have to be found to be noncorporate as a matter of law."[101] The factors focus on the relationship between the opportunity and characteristics of the corporation. The plaintiffs have the burden of proof on this threshold inquiry.[102]

If the court deems the opportunity to be a corporate one, then the analysis proceeds to the second step, which consists of an application of the fairness test.[103] It requires an evaluation of the equitable considerations existing before,

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Fairness to Corporation Where "Corporate Opportunity" is Allegedly Usurped by Officer or Director, 17 A.L.R.4TH 479 (1982); Note, *Opportunity Knocks*, *supra* note 12, at 259.

98. 301 Minn. 207, 222 N.W.2d 71 (1974).

99. The corporation was started by their parents and had grown into a substantially large business. *Id.* at 210, 222 N.W.2d at 73.

100. *Id.* at 224, 222 N.W.2d at 73.

101. *See id.* at 225, 222 N.W.2d at 81.

102. *Id.*

103. *Id.* A finding, however, of a corporate opportunity may end the inquiry and impose liability on the defendant if the opportunity is essential to the corporation and deprivation would directly interfere with existing corporate activities. *Id.* at 225-26, 222 N.W.2d at 82.

during, and after the fiduciaries' development of the opportunity. The court offers another series of factors, all of which relate to the defendants' capacities and conduct regarding the opportunity.[104] Despite this focus on the defendants' actions, the court emphasized that a finding of bad faith is not necessary to finding liability, nor is a finding of good faith sufficient to preclude liability.[105] Defendants have the burden of proof in this fairness inquiry.[106]

The court's explanation of the steps was not followed by an explanation of how step one of the test applied to the *Miller* facts. The court concluded, without elaboration, that three of the five businesses could be deemed to be opportunities belonging to the corporation because they were in the line of business of the corporation.[107] Under the *Guth* test, this conclusion would be sufficient for finding liability.[108]

In the second step of their analysis, however, the *Miller* court determined that the defendant brothers ultimately were not liable.[109] The court considered a variety of factors—in particular that defendants' dealings with the corporation were fair and that defendants carried out their corporate duties in good faith.[110] Not only was there no egregious behavior, but the fiduciaries devoted their best efforts to the corporation through working long hours, developing new lines of business, lending the corporation money when needed, and transacting all business between the corporation and their separate businesses at terms that were profitable to the corporation. They even made one of the businesses a captive purchaser of the corporation.[111] Furthermore, no corporate resources were used to develop the businesses. The relevant factors on which the court premised their conclusions were that defendants apparently performed their basic responsibilities to the corporation diligently and that they did not harm the corporation by unfair bargaining or use of its resources.[112]

The *Miller* test differs from the other traditional tests in a fundamental way; it does not presume the fiduciaries' use of an opportunity deemed to belong to the corporation automatically results in a breach of duty. Under the *Miller* test, if the court deems the opportunity to belong to the corporation under step one, the fiduciaries' liability does not automatically follow. Rather the court presumes that there are circumstances under which the fiduciaries' taking of an opportunity that belongs to the corporation may be justified. The court thus contributes a significant analytical distinction that subsequent courts have followed in their formulations of two-step tests.[113]

104. *Id.* at 226, 222 N.W.2d at 81-82.
105. *Id.* at 226, 222 N.W.2d at 82.
106. *Id.* at 227, 222 N.W.2d at 82.
107. *Id.* at 227, 222 N.W.2d at 82-83.
108. *See supra* text accompanying notes 67-82.
109. *Miller*, 301 Minn. at 227-29, 222 N.W.2d at 82-83.
110. *Id.*
111. *Id.* at 228, 222 N.W.2d at 83.
112. *Id.* at 228-29, 222 N.W.2d at 83.
113. *E.g.*, Ellzey v. Fyr-Pruf, Inc., 376 So. 2d 1328 (Miss. 1979); Warren v. Century Bankcorp., Inc., 741 P.2d 846 (Okla. 1987); Nicholson v. Evans, 642 P.2d 727 (Utah 1982).

In addition, the *Miller* court's scrutiny of the fiduciaries' conduct suggests a possible implicit consideration of the fiduciaries' perspective. The other traditional tests and landmark cases study the fiduciaries' conduct only to assess the extent to which the fiduciaries' conduct harmed the corporation or if the fiduciaries learned of the opportunity in their personal or corporate capacities.[114] While *Miller* considered these factors, it also assessed whether the fiduciaries satisfied their general corporate responsibilities. The court concluded that the fiduciaries' diligence and good faith in performing their general corporate role was persuasive evidence that they acted properly regarding the contested opportunities.[115] The time and talent the fiduciaries used to manage five other corporations did not interfere with their duties to the corporation. This conclusion implicitly recognizes that fiduciaries agree to perform properly one hundred percent of the job they have accepted, but that they have not assigned to the corporation their talents, energies, and efforts beyond that, unless they have expressly agreed to do so.

On the other hand, the *Miller* court did not recognize other facts relevant to the parties' reasonable expectations. For example, defendants developed the five businesses over the span of a decade. Thus, it would seem reasonable for the defendant brothers to have assumed that the corporation had waived any claims it might have to these ongoing activities. Moreover, the *Miller* test, like the other tests, did not explicitly acknowledge societal interests clearly implicated by the facts. The court did not acknowledge, for example, that precluding defendants from the opportunities might hinder the creation of new businesses or interfere with the individuals' freedom to pursue their interests in the business forms of their choice.

In summary, traditional corporate opportunity tests do not explicitly acknowledge noncorporate interests. In at least three ways, however, a consideration of the fiduciaries' interests and perspective may be implied. As discussed above, the first is found in *Miller v. Miller*.[116] There the court considered the fiduciaries' diligence to their corporate responsibilities in concluding that the fiduciaries were not liable.

Second, cases following the expectancy test, either in its traditional articulation in *Lagarde* or in its revived articulation in more recent Georgia cases, define opportunities belonging to the corporation as those with which the corporation has a contractually based claim.[117] Particularly in contrast to the line of business test, the expectancy test defines the corporation's proprietary rights narrowly. One may infer that by defining the corporation's proprietary rights narrowly and thus inherently defining the opportunities that the fiduciaries may pursue expansively, the test is implicitly acknowledging and protecting the fiduciaries' interests.

Third, an analysis of the outcomes of the cases of the last decade reveals

114. *See supra* text accompanying notes 82, 92-93, 97.
115. *Miller*, 301 Minn. at 228, 222 N.W.2d at 83.
116. *See supra* text accompanying notes 98-115.
117. *See supra* text accompanying notes 83-93 and *infra* text accompanying notes 187-225.

that the fiduciaries in those cases were as likely to win as the corporation.[118] One explanation for this result is that courts, while not articulating their reasoning, implicitly or intuitively considered noncorporate interests. If the courts truly considered only the corporate interest, one would have predicted that the corporation would have won more cases than the fiduciaries.

While these examples illustrate that courts are following their instinct that the stated principles of the doctrine are unbalanced, such an inferential or implicit recognition of competing interests is not enough. The corporate opportunity doctrine should directly acknowledge the existence of individual and social interests.

IV. The Evolving Doctrine

A study of how the corporate opportunity doctrine has evolved in the last decade reveals that the law is in transition. There is considerable variation among states' laws.[119] In some jurisdictions the law is confused and unpredictable. In other jurisdictions the courts are gravitating toward one or more emerging models by which to resolve corporate opportunity disputes. This Article continues with a brief exploration of the doctrinal confusion found in some jurisdictions and then turns its attention to a detailed review of the emerging models.

A. *Doctrinal Confusion*

Some courts are clearly struggling with the inadequacies of the traditional tests.[120] Some cases reflect an ambivalent, sometimes incomprehensible approach to corporate opportunity problems. The courts cite traditional tests in an almost perfunctory way, but the test on which they actually rely is sometimes

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118. *See supra* note 2.

119. Under the internal affairs rule, the law of the state of incorporation governs disputes arising from the internal operations and relationships of the corporation, including the fiduciary duties of directors and officers. Diedrich v. Miller & Meier & Assoc., 254 Ga. 734, 334 S.E.2d 308 (1985); RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS §§ 302, 313 (1971); Kozyris, *Corporate Wars and Choice of Law,* 1985 DUKE L.J. 1, 3-5.

Some courts, however, do not recognize the choice of law issue. *See, e.g.,* Southeast Consultants, Inc. v. McCrary Eng'g Corp., 246 Ga. 503, 273 S.E.2d 112 (1980) (applying Georgia law to a Wisconsin corporation); Sabre Farms, Inc. v. Jordan, 78 Ore. App. 323, 717 P.2d 156 (1986), *petition denied,* 80 Or. App. 789, 723 P.2d 1078 (1986) (applying Oregon law to a Montana corporation); *cf. Diedrich,* 254 Ga. at 736, 334 S.E.2d at 310 (addressing choice of law issue in *McCrary,* 246 Ga. 503, 273 S.E.2d 112).

The law chosen can alter the litigation outcome. For example, in Tuckman v. Aerosonic Corp., No. 4094 (Del. Ch. May 20, 1982) (LEXIS, States library, Omni file), the court acknowledged that Florida law was the applicable law but applied Delaware law on the assumption that Florida law was the same. At that time the Fifth Circuit had interpreted Florida law as adopting a type of line of business test. Farber v. Servan Land Co., 662 F.2d 371, 377-78 (5th Cir. 1981) (inquiring whether the opportunity was within the valid corporate purpose, whether it "fit" into present activities or established corporate policies). In contrast, the Delaware Supreme Court had used a test based on the corporation's expectancy and capabilities. Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 963 (Del. 1980). The *Tuckman* court's erroneous application of Delaware law imposed a different test, and arguably a different outcome, on the litigants than would have resulted under Florida law.

120. Courts have recognized repeatedly the problems and confusion of the traditional tests. *See, e.g.,* Miller v. Miller, 301 Minn. 207, 222, 222 N.W.2d 71, 79 (1974) (explaining its search in vain for an appropriate test).

unrecognizable as the traditional tests cited.[121] Because the traditional tests and the eventual results are not consistent, these courts often cannot provide logical, well-reasoned explanations for the results. They instead follow the routine of elaborately stating the facts, citing the tests, and announcing their conclusion. Unfortunately, the analytical step of explaining how the legal principles are applied to the facts to reach the indicated legal conclusion often is missing.

The result is that various jurisdictions appear to have incongruent and unpredictable approaches to corporate opportunity disputes. Even within the same jurisdictions, the courts sometimes cite different tests.[122] Even when the courts

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121. For example, while stating that *Guth* is the applicable law, courts use different techniques to avoid its application—commonly to constrict the expansiveness of the test. For instance, the Delaware courts impose a corollary, based on Equity Corp. v. Milton, 43 Del. Ch. 160, 164, 221 A.2d 494, 497 (1966), on the *Guth* test that narrows its application considerably. Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 963-64 (Del. 1980); Schreiber v. Bryan, 396 A.2d 512, 518-19 (Del. Ch. 1978). The corollary transforms the test to three required elements: the opportunity is essential to the corporation or is one in which there is an interest or expectancy; the fiduciaries take the opportunity while in their corporate rather than individual capacities; and the corporation is financially able to exploit the opportunity. *Schreiber*, 396 A.2d at 519. Although the courts call this a corollary to the *Guth* test, a review of the elements indicates the elimination of the line of business analysis. Therefore, the corollary effectively replaces the traditional test.

The court in Lussier v. Mau-Van Dev., 4 Haw. App. 359, 368-69, 667 P.2d 804, 813 (1983), took a second approach to avoiding the line of business test, citing Hill v. Hill, 279 Pa. Super. 154, 420 A.2d 1078 (1980). The court cited *Guth* as the applicable test, but stated that it must dispense with threshold issues prior to applying *Guth. Lussier*, 4 Haw. App. at 368, 667 P.2d at 813. The threshold inquiries are the corporation's financial inability to pursue the opportunity, the fiduciaries' disclosure regarding the opportunity and receipt of corporate consent, and the noninjury of corporate creditors. *Id.* at 368-69, 667 P.2d at 813. If the parties cannot substantiate these conditions, then the *Guth* test is never reached. *See id.* at 370, 667 P.2d at 813. In *Lussier*, substantiation was a simple matter because expansive standards determined financial inability, disclosure and consent. *Id.* at 367-70, 667 P.2d at 812-13. The court measured financial inability on a lack of liquid funds rather than on a lack of credit potential. The fiduciary made its disclosure to the corporation informally, and the court implied the corporation's consent by its failure to object. *Id.* at 367, 667 P.2d at 812-13. With these findings the court simply preempted the *Guth* test.

In contrast, some courts adhere carefully to the *Guth* analysis. *See, e.g.*, Stangeberg v. Allied Distrib. & Bldg. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file); Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358, 368 (Tex. Ct. App. 1986). A number of courts also continue to use some form of the line of business test. Several Illinois cases, for example, inquire whether the opportunity is "reasonably incident" to the corporation's activities. *See* Lindenhurst Drugs, Inc. v. Becker, 154 Ill. App. 3d 61, 67, 506 N.E.2d 645, 650 (1987); Peterson Welding Supply Co. v. Cryogas Prods., Inc., 126 Ill. App. 3d 759, 764, 467 N.E.2d 1068, 1072 (1984). In addition, one basis for determining when a fiduciary should disclose an opportunity under the ALI model is whether the opportunity is closely related to the corporation's business. ALI Draft, *supra* note 25, § 5.05(b)(2) illus. 4, at 113.

122. Illinois courts use different tests without explaining the distinctions. Several cases interpreting Illinois law cite a variation of the line of business test, asking whether the opportunity is "reasonably incident to the corporation's present or prospective business and is one in which the corporation has the capacity to engage." *See* Lindenhurst Drugs, Inc. v. Becker, 154 Ill. App. 3d 61, 67, 506 N.E.2d 645, 650 (1987); Peterson Welding Supply Co. v. Cryogas Prods., Inc., 126 Ill. App. 3d 759, 764, 467 N.E.2d 1068, 1072 (1984); *see, e.g.*, Carlstead v. Holiday Inns, Inc., No. 86C 1927 (N.D. Ill. Oct. 9, 1986) (LEXIS, Genfed library, Courts file); Weigel v. Shapiro, No. 78C 668 (N.D. Ill. Oct. 2, 1978) (LEXIS, Genfed library, Courts file). One of these cases, however, interprets this "reasonably incident" test as the expectancy test. *Lindenhurst*, 154 Ill. App. 3d at 68, 506 N.E.2d at 650. Other Illinois cases select a variety of tests, focusing on the fiduciaries' use of corporate resources. *See, e.g.*, Graham v. Mimms, 111 Ill. App. 3d 751, 763-64, 444 N.E.2d 549, 557 (1982) (focusing on the fiduciaries' use of corporate resources, or the corporation's legal ability to pursue the opportunity), *cert. denied*, 93 Ill. Rep. 2d 542 (1983); Valiquet v. First Fed. Sav. & Loan Ass'n, 87 Ill. App. 3d 195, 203-04, 408 N.E.2d 921, 927-28 (1980) (same), *cert. denied*, 81 Ill. Rep. 2d 606 (1980). Another Illinois case considers whether the corporation has an expectancy in the opportunity and whether the fiduciary's acquisition of the opportunity would hinder the corporation's busi-

cite the same test, they interpret them differently.[123]

Two Pennsylvania cases particularly illustrate these inconsistencies.[124] *Ampersand Productions, Inc. v. Stahl*[125] involved a corporation that produced plays. A shareholder and officer produced, on his personal behalf, a new play that was originally written for the corporation. The *Ampersand* court held that the opportunity was clearly within the "scope of corporate activities" and that the fiduciary used corporate assets to develop the opportunity.[126] No liability was imposed, however, because the play was not profitable and the fiduciary thus was not unjustly enriched.[127] *CST, Inc. v. Mark*[128] had strikingly analogous facts. A corporation involved in the advertising business produced a travel guide to be used as an advertising supplement in newspapers in the state of Virginia. An officer of the corporation negotiated to produce a revised edition of the travel guide through his own private company, even though the corporation was clearly interested in pursuing the project itself.[129] The officer ultimately returned the project to the corporation, although the corporation was financially unable to develop the project. Without articulating a particular test, the *CST* court concluded that the officer breached his duty because he never received the corporation's consent and that the corporation, although financially strained, was not insolvent.[130] The court then turned to the issue of the fiduciary's liability. Since he had returned the project to the corporation, he was not unjustly

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ness plans and purposes. Comedy Cottage, Inc. v. Berk, 145 Ill. App. 3d 355, 360, 995 N.E.2d 1006, 1011 (1986) (essentially the same formula used in a Colorado case, Three G Corp. v. Daddis, 714 P.2d 1333, 1336 (Colo. Ct. App. 1986)). Although the Illinois Supreme Court focuses on agency principles and disclosure, *see* Mullaney, Wells & Co. v. Savage, 78 Ill. 2d 534, 546-50, 402 N.E.2d 574, 583 (1980), lower state courts and federal courts apparently have chosen not to follow that precedent.

123. Recent Massachusetts cases, for example, reveal the lack of a cogent and predictable line of reasoning and analysis. *See, e.g.*, Martin v. Kagann (*in re* Tuffs Elecs., Inc.), 746 F.2d 915, 917 (1st Cir. 1984) (calling the corporate opportunity doctrine a rule of disclosure, but not elaborating on what test or procedure is applicable); O'Hara v. Robbins, 11 Mass. App. Ct. 279, 283-84, 432 N.E.2d 560, 563 (1982) (citing no test at all, but referring instead to BBF, Inc. v. Germanium Power Devices Corp., 13 Mass. App. Ct. 166, 430 N.E.2d 1221 (1982), which only generally discussed the duty of loyalty and the importance of fiduciaries following instructions), *appeal denied*, 386 Mass. 1102, 440 N.E.2d 1175 (1982); Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 299-302, 438 N.E.2d 391, 393-94 (1982) (citing Durfee v. Durfee & Canning, Inc., 323 Mass. 187, 80 N.E.2d 522 (1948), without identifying its fairness test, noting instead that the activity of the new business is clearly within the corporation's activities).

124. Other cases support the conclusion that there is no apparent agreement on the appropriate corporate opportunity test to be used in Pennsylvania. One case cites no test at all and offers no reasoning before concluding that liability under the doctrine is appropriate, citing only a state statute, PA. STAT. ANN. tit. 15, § 1408 (Purdon 1967) (repealed 1986), on ficuciary duty of due care. S.N.T. Indus. v. Geanopulos, 363 Pa. Super. 97, 102, 525 A.2d 736, 739 (1987) (per curiam). Another case, Hill v. Hill, 279 Pa. Super. 154, 420 A.2d 1078 (1980), emphasizes disclosure, stating that a fiduciary may seize a corporate opportunity if the shareholders consent and if it is not harmful to creditors. *Id.* at 163, 420 A.2d at 1082. Although other Pennsylvania cases cite *Hill*, they do not follow its analysis.

125. No. 85-4358 (E.D. Pa. Feb. 20, 1986) (LEXIS, Genfed library, Courts file).

126. *Id.*

127. *Id.*

128. 360 Pa. Super. 303, 520 A.2d 469 (1987).

129. *Id.* at 306-07, 520 A.2d at 811.

130. *Id.* at 309-10, 520 A.2d at 471-72.

enriched.[131] The court nonetheless concluded that the fiduciary was liable for lost profits, even though neither he nor the corporation had received any revenue from the venture.[132]

In both *Ampersand* and *CST*, the corporation had substantial prior dealings related to the opportunity and indicated an interest in pursuing the new opportunity. The fiduciaries in these cases nonetheless pursued the opportunity on their own behalf. Neither fiduciary, however, benefitted economically from his endeavor. In *Ampersand* the fiduciary brought the play to production but it yielded no profits. In *CST* the fiduciary never implemented the project. Although the facts were strikingly analogous, the courts treated the cases differently, applying different tests and following different theories upon which remedies should be based. *Ampersand* imposed a variation of the line of business test, recognizing that the opportunity was exactly the type of business activity the corporation ordinarily pursued.[133] *CST* instead emphasized two factors: first, whether the fiduciary disclosed and the corporation consented to the fiduciary's taking of the opportunity; and second, whether the corporation had the theoretical ability to pursue the opportunity.[134] The courts also differed on whether liability was contingent on the fiduciaries' unjust enrichment. In what would appear to be a stronger case for the fiduciary because of the fiduciary's attempt to rectify his conduct and the corporation's actual inability to pursue the opportunity, the court in *CST* nonetheless penalized the fiduciary despite the absence of unjust enrichment. It presumably reasoned that the deterrent effect merited the harsh remedy.

The doctrinal inconsistencies illustrated above in the Pennsylvania cases can be explained. The courts are dissatisfied with the results of the traditional tests, yet feel constrained by generations of cases citing these tests as the appropriate standards. The courts intuitively believe that the tests are incomplete and unbalanced but do not articulate the relevant policy interests. The resulting legal principles are therefore unclear and inadequate.

Some courts are responding to the inadequacies of the traditional tests and the doctrinal confusion by seeking a more coherent basis upon which to resolve these disputes. These courts are emphasizing a certain aspect of the circumstances surrounding the corporate opportunity, namely, the corporation's capability, the corporation's reasonable expectations, or the fiduciaries' disclosure. While these factors are relevant factors under the traditional tests, they assume a more dominant and integral role with recent courts, often becoming a conceptual core around which the disputes are resolved. Although the courts have not labeled them as such, these aspects can be viewed for analytical purposes as the bases for three emerging models: (1) the corporate capability model,[135] (2) the corporate expectations model,[136] and (3) the disclosure model.[137] The adopting

131. *Id.* at 310, 520 A.2d at 472.
132. *Id.* at 306-07, 520 A.2d at 472-73.
133. *See Ampersand*, No. 85-4358 (E.D. Pa. Feb 20, 1986) (LEXIS, Genfed library, Courts file).
134. *See CST*, 306 Pa. Super. at 309-310, 520 A.2d at 471-72.
135. *See infra* text accompanying notes 140-86.
136. *See infra* text accompanying notes 187-225.

courts hope these models, as summarized in Table 2, provide a coherent basis for resolving corporate opportunity disputes. At the same time, each model has

TABLE 2. EMERGING CORPORATE OPPORTUNITY MODELS

Model	Key Inquiries	Consequences
Corporate Capability Model	Was the corporation able (financially, legally, practically) to pursue the opportunity?	If not, then the fiduciaries probably would not be precluded from the opportunity.
Corporate Expectations Model	Is the opportunity within the corporation's reasonable expectations?	If so, then the fiduciaries are precluded from the opportunity.
Disclosure Model	Did the fiduciaries disclose the opportunity and the corporation consent to the fiduciaries' taking of it?	If not, then the fiduciaries are precluded from the opportunity.

certain attributes on which the adopting courts apparently place a high value. The corporate capability model serves efficiency goals, the corporate expectations model reflects the corporation's understanding of its rights, and the disclosure model serves the administrative goals of ease of monitoring and reasonable objectivity. These models are not exclusive and courts have combined aspects of more than one model or other considerations in their analyses.[138] While the models have noteworthy benefits, they all have one fundamental shortcoming. The models focus exclusively on protecting the interests of the corporation; they do not acknowledge competing societal and individual interests.[139]

B. *Corporate Capability Model*

While the traditional line of business test asks whether the corporation conceivably could adapt its resources in order to exploit the contested opportunity, some courts in recent cases have found this inquiry too speculative. These courts instead ask the more objective question of whether the corporation had the actual capacity to develop the opportunity.[140]

137. *See infra* text accompanying notes 226-32.

138. *See, e.g.*, Lussier v. Mau-Van Dev., Inc., 4 Haw. App. 359, 667 P.2d 804 (1983) (combining corporate capability and fiduciary disclosure); Lindenburst Drugs, Inc. v. Becker, 154 Ill. App.3d 61, 506 N.E.2d 645 (1987) (considered corporate capabilities and expectations as well as fiduciary disclosure); *In re* Saftey Int'l, Inc., 775 F.2d 660 (5th Cir. 1984) (considering corporate expectations and capabilities).

139. *See* Southeast Consultants, Inc. v. McCrary Eng'g Corp., 246 Ga. 503, 509, 273 S.E.2d 112, 117 (1980) (applying corporate expectations model while noting the effect of the line of business test on former officers' ability to compete with the corporation).

140. *See, e.g.*, Quinn v. Cardiovascular Physicians, P.C., 254 Ga. 216, 326 S.E.2d 460 (1985) (business practicality constraints); Lussier v. Mau-Van Dev., Inc., 4 Haw. App. 368, 667 P.2d 804 (1983) (financial capacity); Peterson Welding Supply Co. v. Cryogas Prods., Inc., 126 Ill. App. 3d 759, 467 N.E.2d 1068 (1984) (business practicality constraints); Graham v. Mimms, 111 Ill. App. 3d 751, 444 N.E.2d 549 (1982) (same), *cert. denied*, 93 Ill. 2d 542 (1983); Valiquet v. First Sav. & Loan Ass'n, 87 Ill. App. 3d 195, 408 N.E.2d 921 (legal and financial capacity), *cert. denied*, 81 Ill. 2d 606 (1980); Ellzey v. Fyr-Pruf, Inc., 376 So. 2d 1328 (Miss. 1979) (same); Anderson v. Clemens Mobile Homes, Inc., 214 Neb. 283, 333 N.W.2d 900 (1983) (same); Warren v. Century Bankcorp., Inc., 741

According to this model, a corporation's inability to exploit the opportunity argues against precluding the fiduciaries from pursuing it. Allowing the fiduciaries to exploit an opportunity under these circumstances means that the fiduciaries can be involved in a productive activity in which the corporation could not engage. At the same time, the corporation arguably is not harmed because it could not have pursued and benefitted from the opportunity even if it wanted to do so. To prohibit fiduciaries from exploiting the opportunity under these circumstances would be wasteful, particularly if the opportunity is one that would not be exploited by a third party. Even if a random third party is willing to exploit the opportunity, the fiduciaries, because of their particular background and expertise, may be more efficient and effective at developing it.

The corporate capability model poses several problems. First, by focusing on the corporation's capabilities, it obscures the real issue: Who has the right to exploit the opportunity? If the corporation has that right, then it is up to the corporation to decide whether it will exercise that right and try to develop the opportunity. It may have sufficient resources, but for business strategy reasons or for no apparent reason at all, it may decline to do so. A determination of legal rights should take precedence over the efficiency benefits described above.[141] On the other hand, if the corporation does not have the right to exploit the opportunity, then the fiduciaries may pursue the opportunity regardless of the corporation's capabilities.

In some circumstances, however, who has the right to exploit the opportunity is unclear. For example, both the corporation and the fiduciaries may have legitimate claims. Then the corporation's capabilities are relevant in determining how the parties would reasonably expect to resolve the dispute. The parties probably would not expect the corporation to receive the profits from an opportunity that it truly could not have pursued on its own. Because of its incapacities, the corporation could not have relied upon or expected to pursue the opportunity. In fact, the corporation's receipt of the value of the opportunity could be characterized as an unwarranted windfall.

A second problem with the corporate capability model is the legitimacy of the initial inquiry. A retrospective determination that the corporation was legally or financially incapable of pursuing the opportunity does not necessarily mean that the corporation, if actually given the chance, *would* not have developed the opportunity. If it made economic or business sense to do so, a corporation probably could eliminate these incapacities. For example, it could amend

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P.2d 846 (Okla. 1987) (legal capacity); Klinicki v. Lundgren, 298 Or. 662, 695 P.2d 906, 912 (1985) (same); Stangenberg v. Allied Distrib. & Bldg. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file) (same).

141. A priority of property rights is found in United States intellectual property laws, under which the owners of intellectual property rights may choose not to use the intellectual property even though its use may be of value to others. *See* P. AREADA & L. KAPLIOUS, ANTITRUST ANALYSIS 441 (4th ed. 1988). In contrast, under Chinese law, owners must use the intellectual property or risk losing their proprietary rights to its exclusive use. *See, e.g.*, Patent Law of the People's Republic of China, adopted March 12, 1984 at the 4th Sess. of the Standing Comm. of the 6th Nat'l People's Congress, Art. 52, *reprinted in* LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 195 (trans. 1984) (entity may receive a compulsory license to exploit a patent if patentee does not use patented process within three years of its grant).

its statement of purposes to permit the development of the opportunity, or obtain new funds through additional equity investments or loans. If necessary, it could establish a new company specifically to develop the opportunity. The only real corporate incapacities that would preclude the corporation's exploitation of the opportunity would be those few which it could not alter. For example, the party offering the opportunity may adamantly refuse, for reasons over which neither the corporation nor the fiduciaries have control or can change, to allow the corporation to develop the opportunity. Other than these types of incapacities, the only definitive way to determine if the corporation would have developed the opportunity is for the corporation actually to have considered and rejected the opportunity.[142]

Even assuming the basic legitimacy of analyzing the corporation's capabilities, the courts' current application of the model is incomplete. The courts consider only the corporation's incapabilities. In the same way that the corporation's inabilities may favor the fiduciaries' exploitation of the opportunities, the fiduciaries' inability to exploit successfully the opportunity should favor the corporation's rights to the opportunity. Likewise, the fiduciaries' (or the corporation's) particular talents and advantages in developing the particular opportunity should favor their respective access to the opportunity. Indeed, if the probability of success would be enhanced if the fiduciaries and the corporation jointly exploited the opportunity, then court decisions that encourage this alternative are desirable.[143]

1. Legal Capacity

In theory, limitations on a corporation's legal power or authority may preclude its developing a particular opportunity. A business activity, for example, may be contrary to the corporate purposes stated in the articles of incorporation. While there may be some interpretational differences in the corporation's statement of purposes,[144] a violation of the corporation's purposes would be reasonably easy to identify and substantiate. The instances of these violations would seem rare, considering how broadly the statement of purposes is usually drafted. In addition, amending the statement of purposes is typically a straightforward corporate process, assuming that there is shareholder support for the change.[145]

A second type of legal incapacity may arise when the opportunity is outside the scope of permissible activities of the particular type of institution or enterprise, as limited by laws under which they are created. Banks and other financial institutions, for example, may be prohibited from certain business

142. Requiring fiduciaries to disclose and give the corporation the right of first refusal on all opportunities, however, results in certain costs. *See supra* text accompanying notes 28-30 and *infra* text accompanying notes 227-32.

143. *See also infra* note 335 (discussing different forms of joint development).

144. *See, e.g.*, Coupounas v. Morad, 361 So. 2d 6, 9 (Ala. 1978).

145. *But see* Carrad, *The Corporate Opportunity Doctrine in Delaware: A Guide to Corporate Planning and Anticipatory Defensive Measures*, 2 DEL. J. CORP. L. 1, 27-43 (1977) (offering drafting precautions against future amendments of the corporate purpose).

activities.[146] Finally, the opportunity itself or related activities may violate a contractual provision to which the corporation is a party. For example, loan agreements can restrict expansion of corporate activities or assumption of further debt.

2. Financial Ability

Courts have given much attention to the issue of financial ability and have diverse views on its appropriate role in corporate opportunity disputes. Some treat it as an element of the cause of action or as a defense.[147] Some follow the principle offered in *Irving Trust v. Deutsch*[148] that the issue of financial ability is irrelevant.[149] Those courts believe that allowing the corporation's financial inability to preclude the fiduciaries' liability would tempt fiduciaries to exercise less than their best efforts in obtaining the necessary financial resources for the corporation, or to otherwise manipulate the financial condition of the business so that the corporation appears financially unable to pursue the opportunity.[150]

In contrast to the *Irving Trust* principle, the trend in recent cases is to treat financial ability as relevant. There are various ways in which courts may attempt to determine the corporation's financial inability. The most direct way evaluates the financial feasibility of the corporation's undertaking of the particular opportunity. This requires a comparison between the corporation's financial resources, including accessible debt financing, for expansion or diversification, and the cost of exploiting the specific idea, including the cost of adjustments in the corporation's current facilities.[151] While some courts implicitly use this approach,[152] they do not expressly calculate financial feasibility. The courts' reti-

146. *See, e.g.*, Valiquet v. First Fed. Sav. & Loan Ass'n, 87 Ill. App. 3d 195, 197, 408 N.E.2d 921, 923 (1980) (banks not allowed to enter into insurance business); Warren v. Century Bankcorp., Inc., 741 P.2d 846, 847-48 & n.2 (Okla. 1987) (branch banking prohibited). There may be interpretational differences in determining exactly what activities are prohibited. *See, e.g.*, *Warren*, 741 P.2d at 854 (Wilson, J., dissenting) (indicating that the bank was precluded from the opportunity by branch banking laws).

147. *E.g.*, Lussier v. Mau-Van Dev., Inc., 4. Haw. App 359, 368, 667 P.2d 804, 813 (1983); Ellzey v. Fyr-Pruf, Inc., 376 So. 2d 1328, 1335 (Miss. 1979); Anderson v. Clemens Mobile Homes, Inc., 214 Neb. 283, 289-90, 333 N.W.2d 900, 904-05 (1983); Warren v. Century Bankcorp., Inc., 741 P.2d 846, 849 n.11 (Okla. 1987); Stangenberg v. Allied Distrib. & Bldg. Serv. Co., No. 86-12-II (Tenn. Ct. App. July 9, 1986) (LEXIS, States library, Omni file); *see also* Graham v. Mimms, 111 Ill. App. 3d 751, 444 N.E.2d 549 (1982). For different views on financial ability, see Klinicki v. Lundgren, 298 Or. 662, 667-75, 695 P.2d 906, 910-15 (1985); Note, *Liability, supra* note 65, at 224; Note, *Opportunity Knocks, supra* note 12, at 263; Annotation, *Financial Inability of Corporation to Take Advantage of Business Opportunity as Affecting Determination Whether "Corporate Opportunity" Was Presented*, 16 A.L.R.4TH 185 (1982).

148. 73 F.2d 121 (2d Cir. 1934), *cert. denied*, 294 U.S. 708 (1935).

149. *Id.* at 124; *accord* Brudney, *Insider Securities Dealings During Corporate Crises*, 61 MICH. L. REV. 1, 25 (1962).

150. Irving Trust Co. v. Deutsh, 73 F.2d 121, 124 (2d Cir. 1934), *cert. denied sub nom.* Biddle v. Irving Trust Co., 294 U.S. 708 (1935); *e.g.*, Lowder v. All Star Mills, Inc., 82 N.C. App. 470, 472, 346 S.E.2d 695, 697 (1986) (fiduciary drained the corporate funds into other corporations that he controlled).

151. Since management typically selects from a set of financially feasible business options, the financial feasibility of developing this particular opportunity is not conclusive evidence that the corporation actually would have developed it.

152. *See* Morad v. Coupounas, 361 So. 2d 6, 9 (Ala. 1978); Lussier v. Mau-Van Dev., Inc., 4

cence may be attributable to the speculation and cumbersome evidence needed for such calculations.

The courts' analysis of financial ability is indirect and gross, but is less speculative and demands less burdensome evidentiary requirements. They equate financial ability with corporate solvency, reasoning that an insolvent corporation could not pursue this (or any other) opportunity.[153] One court, for example, found that the corporation's cash flow problems and clearly precarious financial condition were insufficient to substantiate financial inability; corporate insolvency was required.[154] Because insolvency is such a gross measure of financial inability, using it as the standard also gives the corporation the benefit of the doubt that it is financially able to pursue the opportunity.

Ellzey v. Fyr-Pouf, Inc.[155] further illustrates the relevance and determination of corporate insolvency. A fiduciary acquired a lease, bought equipment, and started a business in competition with the corporation. The Supreme Court of Mississippi emphasized that the corporation's solvency and financial capacity was a requisite element of the complainant's case.[156] It explained, however, that there are different types of insolvency: insolvency in a balance sheet sense, temporary insolvency in the equity sense, and solvency with an inability to obtain credit because of a lack of liquidity.[157] The court selected balance sheet insolvency as the appropriate test of financial inability, apparently because it was the most serious and unalterable condition.[158] The court responded to the policy concern that the fiduciaries might manipulate the corporation's financial condition by refusing to deem the corporation disabled if the disability was caused by fiduciaries not paying their debts to the corporation or otherwise breaching their duty.[159]

3. Business Practicality

A third type of incapacity arises when internal or external business obstacles preclude the corporation from pursuing the opportunity. Internal constraints include the corporate management's inability to incorporate the opportunity into its existing production, marketing, personnel, or other func-

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Haw. App. 359, 367-69, 667 P.2d 804, 812-13 (1983); Lowder v. All Star Farms, Inc., 82 N.C. App. 470, 472, 346 S.E.2d 695, 697 (1986).

153. CST, Inc. v. Mark, 360 Pa. Super. 303, 309, 520 A.2d 469, 472 (1987); Nicholson v. Evans, 642 P.2d 727, 731-32 (Utah 1982).

154. *CST*, 360 Pa. Super. at 309-10, 520 A.2d at 472.

155. 376 So. 2d 1328 (Miss. 1979).

156. *Id.* at 1331. The complainant also had to prove that the opportunity had a logical relationship or was essential to the corporation. *Id.* at 1333. If the complainant was able to carry its burden of proof, then the burden shifted to the fiduciaries, who had to prove that they acted diligently and in good faith. *Id.* at 1332-35. This analysis is a version of the *Miller* two-step test, described *supra* text accompanying notes 100-117.

157. *Ellzey*, 376 So. 2d at 1334.

158. *Id.*

159. *Id.* Fiduciaries generally may borrow from their corporation, although the transactions are subject to fairness standards and may require director or shareholder approvals. *See, e.g.*, N.Y. BUS. CORP. LAW §§ 714, 719(a)(4), 1317(a)(1), 1320 (McKinney 1986). Considering these loans, *prior to their maturity*, as part of the corporate coffers for purposes of determining financial ability, could imply that the corporation has a claim to what are technically the fiduciaries' personal funds.

tions.[160] For example, a computer software company may want to pursue the development of a new line of software but may not have the computer specialists to perform the necessary research and development or may not have appropriate distribution channels because their existing product line is targeted at a different market. A professional service corporation of medical doctors may want to pursue a service contract with a local hospital, but the physicians may not have sufficient time to perform the contract.[161] These internal constraints may be surmountable, but at a cost that yields an unacceptable return on the investment. Thus, the opportunity effectively offers no practical benefit for the corporation, although the corporation technically has the financial resources to pursue it.

The corporation may also be precluded from pursuing the opportunity by external constraints. These constraints are largely market and industry conditions that create difficult barriers to the corporation's exploitation of the opportunity.[162] They include a market already dominated by other corporations with economies of scale, buyers who are doggedly loyal to existing competitors and their brands, or substantial difficulty in finding adequate and predictable suppliers.

Of the possible corporate incapacities, these internal and external business obstacles are arguably the most relevant in predicting whether the corporation actually would have, rather than merely could have, exploited the opportunity.[163] To presume the corporation would have pursued the opportunity if given the chance, just because the opportunity as developed by the fiduciaries turns out to be profitable, is mere speculation. A business practicality test that evaluates realistic business and market constraints, along with the opportunity's financial feasibility and return on investment, more accurately reflects actual corporate decision making. The courts nevertheless generally have rejected this analysis, presumably because of traditional judicial hesitation to speculate on management decisions and corporate strategy.[164]

Courts have addressed but have not resolved the business impracticality that occurs when the party controlling the opportunity is unwilling to pursue the opportunity with the corporation. In five cases in which the fiduciaries argued the unwillingness of a third party as a defense, only the court in *Peterson Welding Supply Co., v. Cryogas Products, Inc.*[165] found the argument persuasive.[166]

160. *See, e.g.*, Quinn v. Cardiovascular Physicans, P.C., 254 Ga. 216, 236 S.E.2d 460 (1985).

161. *See Quinn*, 254 Ga. at 219, 326 S.E.2d at 464 (doctors' unavailability to perform the contract was an insufficient defense if the fiduciaries in part caused the inability).

162. *E.g.*, Peterson Welding Supply Co., v. Cryogas Prods., Inc., 126 Ill. App. 3d 759, 762, 467 N.E.2d 1068, 1071 (1984) (area retail distributers would not do business with plaintiff, a wholesale retailer). The fiduciaries also are likely to face the same obstacles in their development of the opportunity.

163. *See* M. PORTER, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS 3-33 (1980); M. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE 1-33, 445-535 (1985).

164. See cases discussed *infra* text accompanying notes 165-86.

165. 126 Ill. App. 3d 759, 467 N.E.2d 1068 (1984).

166. *Id.* at 764, 467 N.E.2d at 1070.

The discussion which follows briefly reviews the five cases and offers a basis on which to distinguish them.

In the first two cases, *Comedy Cottage, Inc. v. Berk*[167] and *Lindenhurst Drugs, Inc. v. Becker*,[168] the fiduciaries were asked to negotiate on behalf of their corporations leases for the corporations' businesses. The lessors declined to grant the leases to the corporations. The fiduciaries subsequently negotiated the leases on their own behalf. Although there was no evidence that the fiduciaries undermined the corporations' interests during negotiations, the courts nonetheless believed that the fiduciaries could not have exercised their best efforts because of their own interests in the opportunities.[169]

In the third case, *Energy Resources Corp., Inc. v. Porter*,[170] the fiduciary was a vice president and chief scientist trying to obtain a research project on behalf of his nonminority corporation. The project required the fiduciary's specialized expertise. Howard University, the institution offering the project, expressed to the fiduciary, who was black, that, consistent with the University's policy goals, the recipient of the project would be a minority business. The fiduciary reported to the corporation, "We're not going to get [the project]."[171] The fiduciary subsequently resigned, started his own business, and obtained the project. The court found that Howard University's unwillingness to grant the project to the corporation was an insufficient defense because the fiduciary had not made a full disclosure to the corporation.[172] The court reasoned that without full disclosure, the corporation would not know of the third party's refusal to deal with them and therefore would not have the option of taking some action to change the third party's position.[173] Moreover, it would be "too difficult to verify the unwillingness to deal and too easy for the executive to induce the unwillingness."[174] Full disclosure requires that the corporation know of the opportunity, of the third party's refusal to deal with the corporation, have a fair statement of the reasons for that refusal, and, by implication, know of the fiduciary's intention to pursue the opportunity personally.[175] As the court stated, "A fiduciary's silence is equivalent to a stranger's lie."[176]

Production Finishing Corp. v. Shields[177] likewise rejected the fiduciary's third party refusal defense because the fiduciary did not make a full disclosure. At the fiduciary's instigation the corporation sought a major steel polishing con-

167. 145 Ill. App. 3d 355, 495 N.E.2d 1006 (1986).

168. 154 Ill. App. 3d 61, 506 N.E.2d 645 (1987).

169. *Comedy Cottage*, 145 Ill. App. 3d at 361, 495 N.E.2d at 1012; *Lindenhurst*, 154 Ill. App. 3d at 70, 506 N.E.2d at 651-52.

170. 14 Mass. App. Ct. 296, 438 N.E.2d 391 (1982).

171. *Id.* at 305, 438 N.E.2d at 395.

172. *Id.* at 305, 438 N.E.2d at 395. For a discussion of the effect of disclosure or nondisclosure in resolving corporate opportunity disputes, see *infra* text accompanying notes 226-32.

173. *Id.* at 300, 438 N.E.2d at 394.

174. *Id.* at 300-01, 438 N.E.2d at 394.

175. *Id.* at 302, 438 N.E.2d at 395

176. *Id.* at 304, 438 N.E.2d at 396 (Brown, J. concurring).

177. 158 Mich. App. 479, 405 N.W.2d 171 (1987) (citing Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 438 N.E.2d 391 (1982)).

tract with Ford Motor Company. The fiduciary, while negotiating on the corporation's behalf, learned that Ford refused to grant the contract to the corporation. Ford's reason was that the corporation would have a monopoly if it received the business, and that this would be disadvantageous to Ford's general bargaining position. Without disclosing Ford's refusal or his own personal interests, the fiduciary then pursued the contract on his own behalf.

Unlike the other four cases, *Peterson Welding Supply Co. v. Cyrogas Products, Inc.*[178] found the third party's refusal defense persuasive.[179] A retail distributor of industrial gases and equipment sought a wholesale distributorship of the same products, but the grantor was adamant that the distributorship be given to a business that operated only on a wholesale level. This requirement was based on a feasibility study indicating that Chicago retail distributors would not buy from a combined retail-wholesale operation.[180] A fiduciary of the retail operation subsequently sought and obtained the distributorship on his own behalf. Plaintiff corporation apparently knew of the grantor's demands but nevertheless argued that the fiduciary did not "take all steps necessary to obtain the opportunity" for the corporation.[181] Under the circumstances, the court concluded that the fiduciary did not breach his duty to the corporation.[182]

The result of the *Peterson* case reflects sound judicial reasoning. To give the corporation a proprietary claim to an opportunity that it could not otherwise obtain is inefficient and contrary to the corporation's and fiduciaries' reasonable expectations. The fiduciary was well suited, because of his particular experience, to develop the opportunity successfully. At the same time, the third-party grantor identified the fiduciary as a party with whom it was interested in working. Precluding the fiduciary's exploitation of the opportunity would force the third party to spend further time and effort locating another qualified party. Moreover, the result in *Peterson* respects the third party's freedom to contract with whomever it wishes, so long as the parties do not violate existing obligations.

The result also accommodates policy concerns regarding the fiduciaries' and corporation's efforts to change the third party's position. The grantor's reason for refusing to do business with the corporation—it was not commercially feasible to grant the distributorship to a retailer—was independent of and could not be influenced by the actions of the fiduciary or the corporation. Short of completely disregarding its current operations and moving into an exclusive wholesale operation—and there was no indication that the corporation was willing to take this drastic action—the corporation's basic retail character constituted a bar to the opportunity.

The third party's reasons for refusal can be analyzed similarly in the other four cases. The lessor's refusal in *Comedy Cottage* and *Lindenhurst* to lease to

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178. 126 Ill. App. 3d 759, 467 N.E.2d 1068 (1984).

179. *Id.* at 764, 467 N.E. 2d at 1072.

180. *Id.* While the corporation could have questioned the credibility and conclusiveness of this or any feasibility study, it is unlikely that the corporation could have swayed the grantor. The grantor apparently was convinced that the study was correct. *See id.*

181. *Id.* at 763, 467 N.E.2d at 1072.

182. *Id.* at 764, 467 N.E.2d at 1072.

the corporation apparently was based on a subjective preference between lessee candidates.[183] The lessor's preferences may have been alterable by the fiduciaries' or the corporation's efforts. Thus, the courts rejection of the third party defense seems justified.

The results of the two other cases, particularly *Production Finishing*, are not as easily justified under this reasoning. The facts given in the *Energy Resources* opinion do not make clear whether Howard University's requirement that the bid go to a minority business was alterable.[184] As the opinion suggested, the corporation might have been able to ease the university's concerns.[185] In addition, the corporation conceivably could have become a minority-run business. For example, the corporation could have arranged for the fiduciary, a minority person, to share in the profits from the project, or could have set up a separate corporation in which the fiduciary owned a majority interest and the corporation a minority interest, or could even have assisted the fiduciary in setting up his own corporation which, in turn, would have subcontracted the project back to the corporation. There were, however, no indications that the corporation would have been receptive to these proposals.

In *Production Finishing*, Ford's reason for refusing to award the contract to the corporation—that the corporation would consequently have a monopoly—was probably unalterable.[186] An unrelated competitor might have been enticed to enter the market and thus could have prevented the corporation from obtaining a monopolistic position. It is improbable, however, that the corporation would have supported or exerted any efforts toward attracting a competitor and ensuring the competitor a share of its existing market, even if it meant that those actions would have resulted in its winning the Ford contract. Hence, the court's rejection of Ford's refusal to deal with the corporation as a defense, unjustifiably restricted Ford's freedom to contract and failed to recognize the efficiency benefits of the fiduciary exploiting an opportunity that the corporation probably could not have exploited.

C. *Corporate Expectations Model*

Some modern courts are gravitating toward a corporate opportunity model that is actually a revival of the traditional *Lagarde v. Anniston Lime & Stone Co.* expectancy test.[187] They view the doctrine as one that merely carries out the

183. *See Lindenhurst*, 154 Ill. App. 3d at 70-71, 506 N.E.2d at 652; *Comedy Cottage*, 145 Ill. App. 3d at 358, 495 N.E.2d at 1009.

184. *See* Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 300, 438 N.E.2d 391, 395 (1982).

185. *Id.*

186. *See* 158 Mich. App. at 488-89, 405 N.W.2d at 173. If the corporation was the only business available to perform the services, however, Ford would be forced to do business with it or to continue to do the work internally.

187. Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496, 28 So. 199 (1900); *see supra* text accompanying notes 83-89. Courts differ on the significance of whether the opportunity was within the corporation's expectancy. They may regard it as one of two independently sufficient bases for finding liability, as the only sufficient basis, or as merely a relevant factor among other considerations. *See, e.g., In re* Safety Int'l Inc., 775 F.2d 660, 662 (5th Cir. 1985) (requiring expectancy and financial ability); Three G Corp. v. Daddis, 714 P.2d 1333, 1336 (Colo. Ct. App. 1986) (requiring

corporation's original intentions and justifiable expectations. If, at the outset of their relationship, the corporation and the fiduciaries do not expressly negotiate the ownership of opportunities of interest to both, then the courts project what the corporation probably would have agreed to if the issue had been raised.[188]

While adhering to this general notion of reasonable expectations, the courts differ widely on what constitutes the general parameters of the corporation's hypothetical original bargain.[189] Some define the corporation's proprietary interest in business opportunities narrowly. They reserve to the corporation only those opportunities to which it has an express contractual right, essentially patterning its reasoning after *Lagarde*'s expectancy test.[190]

Other courts have endowed the corporation with a proprietary interest in all business opportunities with which it has had some prior dealings. For example, the corporation's attempt to obtain a lease[191] or to renew a lease[192] has been held to result in protectable expectancies.[193] Some courts go further, endowing the corporation with a protectable expectancy even if it has not taken any actions regarding the opportunity. One court took into consideration

> the fact that directors had undertaken to negotiate in the field on behalf of the corporation, or that the corporation was in need of the particular business opportunity to the knowledge of the directors, or that the business opportunity was seized and developed at the expense, and with the facilities of the corporation . . . .[194]

Under these more expansive views of the corporation's rights, fiduciaries may not pursue an opportunity once the corporation has shown an interest in an opportunity, particularly if it is an opportunity that the corporation needs.

Georgia cases exemplify the use of a corporate expectations model. Beginning with the landmark case of *Southeast Consultants, Inc. v. McCrary Engineering Corp.*,[195] the Georgia Supreme Court introduced a moderate view of the corporation's rights that evolved into a more restrictive approach in subsequent cases. In *McCrary* the corporation was an engineering firm specializing in mu-

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either expectancy or the hindrance of the corporate purpose); Comedy Cottage, Inc. v. Berk, 145 Ill. App. 3d 355, 360, 495 N.E.2d 1006, 1011 (1986) (requiring expectancy and the hindrance of the corporate purpose); Sauer v. Moffitt, 363 N.W.2d 269, 273 (Iowa Ct. App. 1984) (requiring expectancy and that the opportunity be essential); Poling Transp. Corp. v. A & P Tanker Corp., 84 A.D.2d 796, 796, 443 N.Y.S.2d 895, 897 (1981) (mem.) (requiring expectancy).

188. *See, e.g.*, United Seal and Rubber Co. v. Bunting, 248 Ga. 814, 815, 285 S.E.2d 721, 722 (1982); Southeast Eng'g Consultants v. McCrary Eng'g Corp., 246 Ga. 503, 273 S.E.2d 112 (1980); *Lindenhurst*, 154 Ill App. 3d 61, 506 N.E.2d 645 (1987); *Comedy Cottage*, 145 Ill. App. 3d 355, 495 N.E.2d 1006 (1986).

189. *See, e.g., Three G Corp.* , 714 P.2d at 1336 (corporation's financial inability takes opportunity out of corporation's expectations).

190. *See, e.g., United Seal*, 248 Ga. at 815, 285 S.E.2d 722.

191. *Lindenhurst*, 154 Ill. App. 3d at 63, 506 N.E.2d at 650.

192. *Comedy Cottage*, 145 Ill. App. 3d at 360, 495 N.E.2d at 1011.

193. *See Lindenhurst*, 154 Ill. App. 3d at 68, 506 N.E.2d at 650; *Comedy Cottage*, 145 Ill. App. 3d at 360, 495 N.E.2d at 1011.

194. Gauger v. Hintz, 262 Wis. 333, 351, 55 N.W.2d 426, 436 (1952) (quoting 3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 861.1 (rev. perm. ed. 1975)).

195. 246 Ga. 503, 273 S.E.2d 112 (1980); *see* Note, Southeast Consultants, Inc. v. McCrary Engineering Corp.*: Georgia Opens the Door to Corporate Opportunity*, 33 MERCER L. REV. 407 (1981).

nicipal water and sewage projects. The president of the corporation started his own competing business, using the corporation's equipment, offices, and personnel in his business operations over a three-year period. Prior to the president's departure from the corporation, the corporation entered into a contract with a municipality for a preliminary study as part of the competition for a large municipal project. After the president's departure, his own company also competed actively for the large project. The corporation argued that the ex-president should be prevented from competing for the project because it was an opportunity that belonged to the corporation.[196]

In applying the Georgia statute regarding business opportunities,[197] the court began by citing *Miller v. Miller* as providing the applicable test, but proceeded to adopt a significant modification to *Miller*.[198] *Miller* used a line of business test as the first step and a fairness test as the second step.[199] In determining whether former officers have usurped opportunities belonging to the corporation, the *McCrary* court instead inquired whether the corporation had an expectancy to the opportunity.[200] Only after determining that a corporation had an expectancy was it necessary to determine if the fiduciary breached his duty by taking the opportunity.[201] The court in effect changed the first step in the *Miller* test from a line of business test to an expectancy test.[202]

By emphasizing that this change was applicable only to former fiduciaries, the court distinguished between former fiduciaries to whom the expectancy test would now apply and current fiduciaries to whom the line of business test would apparently continue to apply.[203] This distinction is especially significant be-

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196. *McCrary*, 246 Ga. at 504, 273 S.E.2d at 114.

197. GA. CODE ANN. § 14-2-153(a)(1)(c) (1982) (originally codified at GA. STAT. ANN. § 22-714 (1968)). Georgia appears to be the only state with a statute that expressly addresses the corporate opportunity issue. While some courts cite a New York statute, N.Y. BUS. CORP. LAW § 720 (McKinney 1986 Supp. 1988), as providing a statutory basis for a violation of a corporate opportunity duty, that statute does not expressly refer to corporate opportunities. The contribution of the Georgia statute is unclear because the corporate opportunity cause of action existed under common law, and the statute does not define or clarify the test for determining liability. The statute reads:

> Actions against directors and officers. (a) An action may be brought by any of the persons named in subsection (b) of this Code section against one or more directors or officers of a corporation to procure for the benefit of the corporation a judgment for the following relief:
>
> (1) To compel the defendant to account for his official conduct or to decree any other relief called for by his official conduct in the following cases: . . .
>
> (c) The appropriation, in violation of his duties, of any *business opportunity* of the corporation; . . . .

GA. CODE ANN. § 14-2-153(a)(1)(c) (emphasis added).

Appropriate plaintiffs include the corporation, receiver, trustee in bankruptcy, officer, director, judgment creditor, or shareholder in a derivative action. GA. CODE ANN. § 14-2-153(b) (1982). The applicable statute of limitations is four years from the time the cause of action accrued, although it is unclear when the running of the statute of limitations period begins. *Id.* § 14-2-153(c).

198. *McCrary*, 246 Ga. at 507-08, 273 S.E.2d at 117.

199. See *supra* text accompanying notes 98-115 for a discussion of the *Miller* test.

200. *McCrary*, 246 Ga. at 509, 273 S.E.2d at 117.

201. *Id.*

202. *Id.*; see *supra* text accompanying note 92 for a discussion of how outcomes differ depending on whether a line of business test or expectancy test is used.

203. *McCrary*, 246 Ga. at 509 n.2, 273 S.E.2d at 117 n.2.

cause the court, unlike most other courts, astutely recognized that the application of the line of business test effectively precluded all fiduciaries from competing against the corporation.[204] While this may be an appropriate prohibition for existing fiduciaries, the court concluded that it was inappropriate for fiduciaries who had left the corporation.[205] It was not entirely clear, however, why the defendant was deemed to be a former rather than a current fiduciary for purposes of determining the appropriate test. The court apparently reasoned that the appropriate time to determine the fiduciary's status was at the time the fiduciary began to compete actively.[206] Although the legal creation of a company may be an indication of active competition, it is not determinative. Because the fiduciary actively competed for the project after he had left the corporation, the court considered him a former fiduciary.[207]

Applying the expectancy test, the court found that the corporation had a protectable expectancy in the opportunity because of its prior dealings; the opportunity was one in which the corporation had a "beachhead."[208] Furthermore, as required by the second step in the analysis, the court found that the fiduciary acted unfairly and breached his duty by setting up the competing business, using the corporation's resources, and hiring away the corporation's employees.[209]

While other courts have defined the corporation's expectancy as ranging from only opportunities supported by a binding contractual claim to all opportunities in which the corporation has an interest,[210] the court in *McCrary* took a moderate view of the corporation's rights. Although the corporation had previously negotiated for the project, the city was not committed to award it the job. Nevertheless, the corporation was one of several final contenders, and the court presumed that the corporation's active competition for the project was a sufficient basis for its reasonable expectation in the project.[211]

Although this holding represents a moderate view of the corporation's expectations, its practical impact on the fiduciary was probably drastic. The corporation was actively competing for twenty-two projects, including the one at issue in the case, at the time the fiduciary left the corporation. The court's holding most likely ended any intention the defendants may have had to pursue any of the remaining projects since, under the reasoning of the case, these projects were within the corporation's expectancy. Under the reasonable assumption that these projects constituted much if not all of the available business that the fiduciaries' new company could pursue in the foreseeable future, the denial of all

204. *Id.* at 509, 273 S.E.2d at 117; *see supra* text accompanying notes 19-25.

205. *McCrary*, 246 Ga. at 509 n.2, 273 S.E.2d at 117 n.2.

206. *See id.*

207. *See id.* The court indicated, however, that even if the fiduciary was deemed to be a current fiduciary, and hence the line of business test would be applicable, the result would be the same. *Id.*

208. *Id.* at 509, 273 S.E.2d at 117.

209. *See id.* at 509-10, 273 S.E.2d at 117-18.

210. *See, e.g.*, United Seal & Rubber Co. v. Bunting, 248 Ga. 814, 815, 285 S.E.2d 721, 722 (1982) (contractual relationship required).

211. *See id.*, at 509, 273 S.E.2d at 118.

of these projects most probably ended the fiduciaries' venture.[212]

A series of subsequent Georgia Supreme Court cases interpreted more narrowly the opportunities to which the corporation had an expectation. In *United Seal & Rubber Co. v. Bunting*[213] the corporation sold gaskets, seals, and rubber products in the southeastern United States. Three directors and officers left the corporation to start a competing business, eventually attracting customers that represented approximately fifty percent of the corporation's gross income.[214] Applying the expectancy test, the court found that the corporation had no protectable expectancy to the customers since no contractual relationship of exclusivity governed their relationship.[215] Although they were major and long-standing customers, theirs was still an "ongoing relationship with no finite aspect."[216]

The *United Seal* court distinguished *McCrary* as dealing with a specific contract and a finite project.[217] This distinction, however, may be overstated. While a contract existed in *McCrary*, it was only for a nonexclusive preliminary study and did not commit the municipality to any further relationship with the corporation. Thus, it was evidence of the corporation's prior interest and dealings but was not a legally enforceable contractual claim to the opportunity. In addition, the contract in *McCrary* was only one of many that the corporation was pursuing, which makes it analogous to the "ongoing relationship[s] with no finite aspect" customer relationships in *United Seal*.[218]

Two years later in *Sofate of America, Inc. v. Brown*[219] the corporation again contested a former fiduciary's taking of key customers. Following the analysis in *United Seal*, the court required a contractual relationship prior to finding that the corporation had an expectancy to the customers.[220] In *Singer v. Habif, Arogeti & Wynne, P.C.*,[221] a case decided in the same year as *United Seal*, the court took an even narrower view of the rights of professional corporations, finding that a professional corporation of accountants had no expectancy to retain existing clients.[222] Even though the professional corporation had engagement letters with the clients, the letters did not prohibit the clients from leaving. Clients' use of professional services, the *Singer* court offered in dictum, are terminable at will.[223] In *United Seal*, *Sofate*, and *Singer* the court's determination that the corporation had no protectable expectancy resulted in the finding of nonliability.

212. *Id.* at 504, 273 S.E.2d at 114.
213. 248 Ga. 814, 285 S.E.2d 721 (1982).
214. *Id.* at 815, 285 S.E.2d at 722.
215. *Id.* at 816, 285 S.E.2d at 723.
216. *Id.*
217. *Id.*
218. *See also id.* at 817-18, 285 S.E.2d at 724 (Weltner, J., dissenting) (concluding that a long-standing customer relationship is a protectable business opportunity).
219. 171 Ga. App. 39, 318 S.E.2d 771 (1984).
220. *Id.* at 43, 297 S.E.2d at 776.
221. 250 Ga. 376, 297 S.E.2d 473 (1982).
222. *Id.* at 377, 297 S.E.2d at 475.
223. *Id.* at 379, 297 S.E.2d at 476 (dictum).

In general, these courts conjectured that if the corporation had anticipated the corporate opportunity dispute at the outset of its relationship with the fiduciary, it would have agreed that the corporation should be entitled to only those opportunities to which it had a contractually based claim. Thus, these courts applied the same expectancy test used in *Lagarde v. Anniston Lime & Stone Co.*, despite its several problems.[224] The test does not enhance the integrity of the corporate-fiduciary relationship because it puts the fiduciaries in an inherently awkward position. Furthermore, the expectancy model in general, at least as it is currently applied, considers only the corporation's expectations, even though an accurate assessment of the hypothetical understanding between the corporation and fiduciaries regarding corporate opportunities does not seem possible without considering the fiduciaries' expectations.[225]

D. *Disclosure Model*

The trend in some recent cases is to require disclosure to the corporation by the fiduciary prior to pursuing an opportunity.[226] A disclosure model essentially allows the corporation to exercise a variation of a right of first refusal on opportunities that the fiduciary must disclose.[227] If the traditional line of business test is used to determine which opportunities the fiduciaries must disclose, the fiduciaries will be required to reveal all opportunities that may be in competition with the corporation or to which the corporation may theoretically adapt its resources. The corporation thus would be afforded its pick of a broad range of opportunities, although it may still have to compete with third parties for the opportunities.

The disclosure model has certain advantages and disadvantages. Requiring fiduciaries to disclose all opportunities in which the corporation may have an interest clearly protects the corporation. Corporations can monitor the fiducia-

224. 126 Ala. 496, 28 So. 199 (1900); *see supra* text accompanying notes 84-93.

225. In contrast to this general tendency in cases adopting a corporate expectations model, the court in Levitt v. Leisure Sports Inc., 734 P.2d 1221 (Nev. 1987), did consider the entire bargain. *Id.* at 1225. The Nevada Supreme Court found that a fiduciary in a hotel and resort development business did not take an opportunity belonging to the corporation. *Id.* The court emphasized that the fiduciary's actions were consistent with a contingency plan that the parties had agreed to with full appreciation of its possibly harsh consequences. *Id.*

226. *See, e.g.*, Carlsted v. Holiday Inns, Inc., No. 86C 1927, (N.D. Ill. Oct. 9, 1986) (LEXIS, Genfed library, Courts file); Lussier v. Mau-Van Dev., Inc., 4 Haw. App. 359, 368-69, 667 P.2d 804, 813 (1983); Hill v. Hill, 279 Pa. Super. 154, 163, 420 A.2d 1078, 1082 (1980) (allowing fiduciary to take opportunity only if opportunity known to shareholders, shareholders consent to the taking, and such taking does not harm corporation); Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358, 363 (Tex. Ct. App. 1986); Nicholson v. Evans, 642 P.2d 727, 730-31 (Utah 1982) (requiring that fiduciary disclose opportunity to corporation and disinterested directors, or shareholders decline the opportunity). *But cf.* Irving Trust Co. v. Deutsch, 73 F.2d 121 (2d Cir. 1934) (precluding the fiduciaries from using the opportunity even if the corporation rejects it), *cert. denied*, 294 U.S. 708 (1935).

227. In a typical right of first refusal, the party possessing the opportunity (offeror) would have an obligation to offer the opportunity to a certain party (e.g., the corporation) before giving the opportunity to a third party. Here, the fiduciaries are the third parties who want to pursue the opportunity but cannot unless they first offer the opportunity to the corporation. Since the fiduciaries do not possess the opportunity, they cannot ensure the corporation receives the opportunity, only that they will no longer compete for it.

ries' loyalty because the fiduciaries effectively would be informing the corporation when they were considering a business activity that might result in a conflict of interest. The corporation also can decide, in light of its business strategy and an assessment of the opportunity's anticipated return on investment, whether it will pursue the opportunity. Retrospective speculation about whether the corporation would have developed the opportunity would be preempted.[228]

In addition, in theory, if the disclosure process is clearly delineated, corporations, fiduciaries, and courts can also readily determine the fiduciaries' compliance with the process. Because courts can objectively measure whether the fiduciaries have made an adequate disclosure and whether the corporation has validly rejected or accepted the opportunity, this model offers an advantage over the other more subjective models and traditional tests.

The courts that have used the disclosure model, however, have not clearly delineated the process. Unresolved issues include such fundamental topics as when disclosure is required, who is obligated to disclose, to whom disclosure must be made, and exactly what information must be disclosed. Furthermore, if the disclosure process mandates numerous steps and has detailed procedural requirements,[229] then compliance with the process may be laborious for both the corporation and the fiduciaries. At the same time, the number of individuals subject to the disclosure process may be expanding.[230] If courts require disclosure of all opportunities in the corporation's line of business, the administrative costs of a laborious process multiply.

While we should not overlook these administrative concerns, the courts presumably will address and gradually resolve these issues so that the process is reasonably efficient. A more fundamental problem that affects how these administrative issues will be resolved is that it does not explicitly consider noncorporate interests. This inadequacy is revealed in at least two significant ways.

First, in answering such basic questions as which opportunities must be disclosed and when fiduciaries must disclose them, courts do not acknowledge the hardships and concerns of the fiduciaries. Any disclosure requirement that forces fiduciaries to reveal their personal professional plans infringes on their right to keep their plans confidential. All employees should provide reasonable notice of their departure to the corporation, but this disclosure ordinarily occurs closer to the time of departure than when disclosure is currently envisioned under the disclosure models. Premature disclosure of one's future plans can negatively affect work relationships and the transition process for the fiduciaries' replacement. It also can jeopardize the opportunity to which the fiduciaries may be rightfully entitled. Disclosure requirements should strike a more just balance between the corporation's legitimate right to know of certain opportunities and the fiduciaries' legitimate right to confidentiality.

228. *See supra* text accompanying note 134-41.

229. For example, the American Law Institute (ALI) proposes a detailed disclosure process discussed *infra* text accompanying notes 237-49.

230. *See supra* text accompanying notes 41-46.

Second, the model's inadequacy is also revealed by its imposition of disclosure obligations solely upon the fiduciaries. Imposing disclosure or notice requirements on the corporation could yield a more efficient process. For example, as previously discussed, it is currently unclear who is subject to the corporate opportunity doctrine.[231] Key employees, for example, are sometimes subject to the doctrine although they do not have the title of director or officer; therefore, they would not have prior notice of their duties to disclose. In addition, as discussed below, it is frequently unclear which opportunities are subject to disclosure.[232] Consequently, fiduciaries are placed in an ambiguous position. One resolution of these problems would be to impose a duty of disclosure on the corporation. As part of that duty, the corporation could be required to notify those individuals it believes are subject to the corporate opportunity doctrine and to indicate which opportunities in particular or in general those individuals are obligated to disclose. By imposing duties on both parties, the disclosure model would enforce the corporate opportunity doctrine in a manner more consistent with the basic understanding and reasonable expectations of the corporation and fiduciaries.

Disclosure requirements do not reflect the reasonable expectations of the parties if the process is undefined and if unilateral obligations are imposed on the fiduciaries. An undefined disclosure process creates administrative burdens on both the corporation and the fiduciaries and infringes unnecessarily and improperly on the rights of the fiduciaries. On the other hand, a disclosure process which is clearly defined and includes mutual disclosure obligations is desirable, allowing the parties to know in advance the type of opportunities that are subject to disclosure. Thus, the corporation can be assured that fiduciaries will not pursue impermissible opportunities without first following the disclosure procedures and fiduciaries can determine whether to pursue a particular opportunity on the basis of their disclosure obligations.

1. Fiduciaries' Conduct

The fiduciaries' duty to disclose an opportunity theoretically arises only when two conditions are met:[233] first, the opportunity is one that presumptively belongs to the corporation; and second, the fiduciaries wish to pursue that opportunity.[234] Although the fiduciaries know whether they wish to pursue the opportunity, determining whether the opportunity belongs to the corporation is often confusing and difficult. Individuals may not only be uncertain about which opportunities presumptively belong to the corporation, they may even be

231. *See supra* text accompanying note 47.

232. *See infra* text accompanying notes 245-57.

233. Although there may not be a duty to disclose, the fiduciaries are still subject to a duty of care if they are delegated to pursue the opportunity on behalf of the corporation. *See* Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957 (Del. 1980); ALI Draft, *supra* note 25, § 5.05(a) comment.

234. *Science Accessories Corp.*, 425 A.2d at 964. *But cf.* Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358, 367 (Tex. Ct. App. 1986) (suggesting that fiduciaries may have an affirmative duty to disclose an opportunity even if the fiduciaries do not wish to pursue it).

unaware that they are fiduciaries and thus should be concerned about deciding who has rights to the opportunity.[235]

Fiduciaries who are in doubt about whether or not an opportunity is subject to the disclosure process likely will follow one of three options.[236] First, out of a sense of caution, the fiduciaries may disclose the opportunity if there is the slightest reason to believe that it may be appropriate to do so. This course of action gives the corporation the most protection, but adds to administrative costs. Second, to avoid the administrative burdens, the fiduciaries may simply drop the idea altogether. The opportunity, therefore, may never be developed. Third, after some consideration of whether the opportunity belongs to the corporation, the fiduciaries may take their chances that it does not. They may go forward with the opportunity with hopes that the corporation will never raise the issue of the propriety of their actions. This course of action encourages an undesirable circumvention of the disclosure process and the corporate opportunity doctrine.

Courts adopting a disclosure model, therefore, should clearly explain when an opportunity presumptively belongs to the corporation and hence must be disclosed. The American Law Institute (ALI) offers a delineation of opportunities that must be disclosed.[237] As part of the ALI disclosure process,[238] as depicted in Figure 2, these opportunities include (1) activities that fiduciaries discover in connection with their corporate performance or that the fiduciaries reasonably believe they are offered because of their corporate capacities,[239] (2) opportunities the fiduciaries learn of through the use of corporate resources if the fiduciaries reasonably expect the opportunity to be of interest to the corporation,[240] or (3) opportunities that the fiduciaries know or should reasonably know are closely related to the corporation's business.[241] Despite this delineation, the ALI acknowledges that the fiduciaries could still be uncertain whether an opportunity meets the criteria.[242] If the fiduciaries do not comply with their duty to disclose because they believe that the opportunity is not a corporate opportunity, they have a second chance to follow the disclosure steps.[243] In addition, the

235. *See supra* text accompanying note 47; *see also supra* text accompanying notes 120-23 (discussing confusion in corporate opportunity case principles).

236. Considering the confused state of the law, fiduciaries' lawyers will not be able to give definitive advice. *See, e.g.*, Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 396, 438 N.E.2d 391, 396 (1982) (Brown, J. concurring) (criticizing attorney's advise to defendant on avoiding a corporate opportunity violation). The most cautious recommendation always would be to disclose fully the opportunity.

237. ALI Draft, *supra* note 25, § 5.05(b). Fiduciaries have a reasonable duty to inquire if they are uncertain whether the person offering the opportunity expects them to offer it to the corporation. *Id.* § 5.05(b) comment c, illustration 1, 2, 4.

238. *Id.*

239. ALI Draft, *supra* note 25, § 5.05(b)(1)(A).

240. ALI Draft, *supra* note 25, § 5.05(b) comment, illustration 4. For a corporate opportunity to exist, the taking of the opportunity need not be harmful to the corporation. *Id.* § 5.05(b)(1)(A) comment.

241. ALI Draft, *supra* note 25, § 5.05(b)(2). The ALI imposes a less burdensome duty on outside directors, requiring disclosure only of those opportunities described in items (1) and (2). *Id.* §§ 5.05(a) comment b, illustration 1.

242. ALI Draft, *supra* note 25, § 5.05.

243. ALI Draft, *supra* note 25, §§ 5.05(d), (d) comment.

corporation may make prior agreements with the fiduciaries regarding the disclosure and taking of corporate opportunities.[244]

Once the duty to disclose arises, the fiduciaries must make an adequate disclosure to the corporation.[245] Although few courts elaborate on what constitutes an adequate disclosure, the authorities that have commented on the subject require that the fiduciaries make a *full* disclosure of both the opportunity and the fiduciaries' possible personal interest in the opportunity.[246] Analogizing to the securities laws, the ALI[247] and *Klinicki v. Lundgren*[248] impose a "materiality" standard. They require that fiduciaries disclose all facts which reasonable persons would be substantially likely to consider important in their decision making.[249]

Oregon has adopted a disclosure model and is the first state to endorse the ALI's disclosure process. The Oregon Supreme Court in *Klinicki* held that a fiduciary's establishment of a competing business based on a key contract for charter flights usurped an opportunity belonging to the corporation.[250] Originally negotiating the contract for the corporation, the fiduciary subsequently pursued it on his personal behalf without disclosing his interest to the corporation. Because the fiduciary's conduct was not in compliance with the ALI's disclosure process, he breached his fiduciary duty.[251]

In the context of a statute of limitations question, a second Oregon case, *Sabre Farms Inc. v. Jordan*,[252] elaborated upon what constitutes adequate disclosure.[253] The fiduciaries informed the directors that a competing potato farm-

244. Principles of Corporate Governance: Analyis and Recommendations § 5.09(d) & comment (Tent. Draft No. 7, April 10, 1987) [hereinafter ALI Draft No. 7].

245. It is not always clear to whom the fiduciary must make a disclosure. Although these issues would need to be resolved in both closely- and publicly-held corporations, the administrative problems would be exacerbated in large public corporations. For example, General Motors may have 200 plants with 20 key employees at each one in addition to the executive staff at headquarters. Do all 4000 or more individuals report every opportunity to the directors? It is unclear if disclosure to the fiduciaries' immediate superior would suffice or if the fiduciaries must disclose to the body with authority to consent to the fiduciaries' taking of the opportunity.

246. *See* Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 301 n.2, 438 N.E.2d 391, 394 n.2 (1982); Klinicki v. Lundgren, 298 Or. 662, 683, 695 P.2d 906, 920 (1985) (en banc); Sabre Farms, Inc. v. Jordan, 78 Or. App. 323, 326, 717 P.2d 156, 159 (1986); Nicholson v. Evans, 642 P.2d 727, 730-31 (Utah 1982); ALI Draft, *supra* note 25, §§ 5.05(a), 1.09.

247. ALI Draft, *supra* note 25, § 1.20 (derived from TSC Indus. v. Northway, 426 U.S. 438 (1976)).

248. 298 Or. 662, 695 P.2d 906 (1985).

249. *See id.* at 681-82, 695 P.2d at 919-20; ALI Draft *supra* note 25, § 1.20 (derived from TSC Indus. v. Northway, 426 U.S. 438 (1976)).

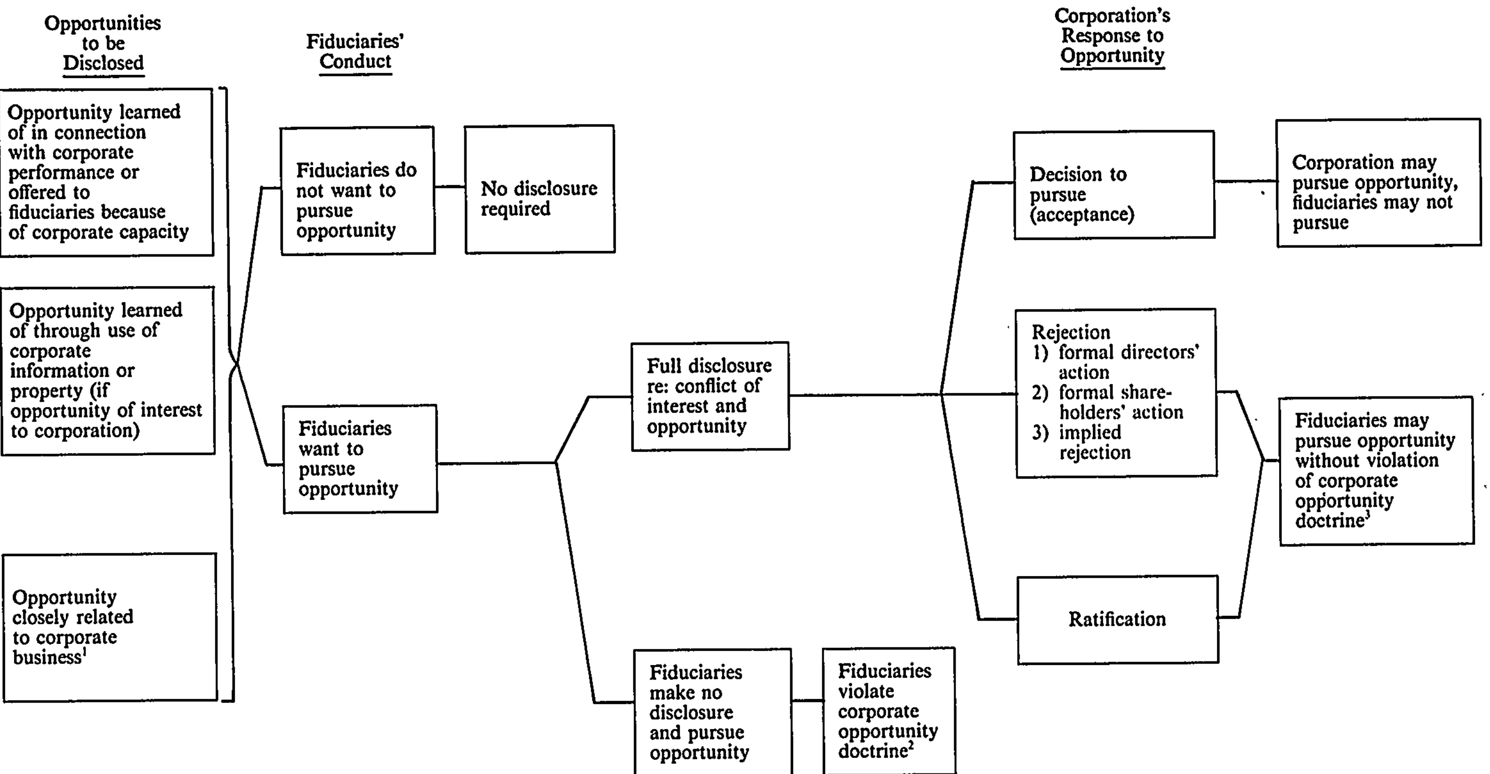
250. *Klinicki,* 298 Or. at 683-84, 695 P.2d at 920; *see also* Note, *An Opportunity to Disclose,* 22 WILLAMETTE L.J. 163 (1986) (discusses *Klinicki* and the effect of a corporation's financial inability to pursue an opportunity on the corporate opportunity doctrine).

251. *Klinicki,* 298 Or. at 664-65, 695 P.2d at 908-09. The applicable Oregon law prior to *Klinicki* is described in Zidell v. Zidell, 277 Or. 423, 560 P.2d 1091 (1977). The standard in *Zidell* precluded fiduciaries from opportunities that would be pursued within corporate policy. *Zidell,* 277 Or. at 429, 560 P.2d at 1093-04. Although the tests in *Zidell* and *Klinicki* are different, the fiduciary in *Klinicki* probably would have been held liable under either test.

252. 78 Or. App. 323, 717 P.2d 156 (1986).

253. The applicable two year statute of limitation begins to run when the plaintiff is aware of every element of the corporate opportunity cause of action. OR. REV. STAT § 12-110(1) (1983). The corporation argued that the fiduciary had not disclosed all information material to a knowledgeable

FIGURE 2. ALI DISCLOSURE PROCESS



[1]Outside directors do not need to disclose these opportunities.
[2]Fiduciaries have opportunity to cure.
[3]Fiduciaries may not pursue the opportunity if there is conflict with ALI § 5.06 on competition with corporation.

ing operation was for sale, and that the fiduciaries had discussed with the seller their interest in purchasing the business in their individual rather than corporate capacities.[254] Six months later the fiduciaries disclosed to the directors that they had entered into a memorandum of intent to make the purchase. The terms of the agreement, however, were kept confidential pursuant to the parties' agreement. The fiduciaries also explained to the directors that they intended to convert the business to an industrial facility and thus actually benefit the financially distressed corporation by removing a competitor.[255] After discussion the disinterested directors voted unanimously to consent to the fiduciaries' taking of the opportunity. In determining that the corporation had received adequate disclosure of the information needed to make this decision despite the fact that the terms of the purchase agreement were kept confidential, the court reasoned that the corporation need not know "*every* fact."[256] "The disinterested directors knew enough, actually or impliedly, to recognize the opportunity, if it was one, and to determine both whether it was one the corporation should and could attempt to take advantage of and whether Jordan and Reid [the fiduciaries] were acting improperly."[257]

While adequate disclosure may include disclosure of both the opportunity and the fiduciaries' interest in it, the courts have only cursorily considered what fiduciaries must reveal about their interest.[258] The *Klinicki* court concluded that the fiduciary's failure to disclose his intent to appropriate the opportunity for himself was, in conjunction with other facts, a violation of his duty.[259] Other courts have implied that the fiduciaries should disclose their self-interest in the opportunity.[260] *Energy Resources* also required that when the party offering the opportunity is unwilling to work with the corporation, then the fiduciaries must "unambiguously disclose that refusal to the corporation . . . together with a fair statement of the reasons for that refusal."[261]

2. Corporation's Response

Following the fiduciaries' disclosure, the corporation has three options. It may decide to pursue the opportunity itself, to reject the opportunity and con-

decision regarding the opportunity, so that the limitations period had not yet begun. *Sabre Farms,* 78 Or. App. at 328-29, 717 P.2d at 159.

254. *Sabre Farms,* 78 Or. App. at 325-26, 717 P.2d at 157-58.

255. *Id.* at 326, 717 P.2d at 158. This conversion apparently never occurred.

256. *Id.* at 329, 717 P.2d at 159 (citing Duncan v. Auger, 62 Or. App. 250, 255, 661 P.2d 83, 86 (1983)).

257. *Id.* at 329, 717 P.2d at 159-60.

258. ALI Draft, *supra* note 25, § 1.09. The ALI draft does not elaborate on what constitutes a conflict of interest other than to require that the fiduciary disclose the "material facts" concerning the conflict of interest. *Id.*

259. Klinicki v. Lundgren, 298 Or. 662, 683, 695 P.2d 906, 920 (1985); *see supra* text accompanying notes 250-51.

260. *See Sabre Farms,* 78 Or. App. at 329, 717 P.2d at 160 (noting defendants' disclosure of their personal interest in concluding that there was adequate disclosure); Energy Resources Corp. v. Porter, 14 Mass. App. Ct. 296, 300-01, 438 N.E.2d 391, 394 (1982) (criticizing the defendant for being secretive about his reasons for leaving the corporation).

261. *Energy Resources,* 14 Mass. App. Ct. at 302, 438 N.E.2d at 395.

sent to the fiduciaries' pursuit of it, or to delay or abstain from any action. The courts vary in what constitutes corporate acceptance, rejection, or abstention, and the consequences of each.[262]

Some courts require that the corporation clearly manifest its decision.[263] For example, in *Farber v. Servan Land Co.*,[264] the shareholders on several occasions discussed whether to acquire the land adjacent to the corporation's golf course and country club. The minutes of their 1968 annual meeting stated: "The stockholders seem to feel that this possibility should certainly be investigated and would be made financially feasible by the refinancing."[265] The shareholders, however, took no formal action and the corporation made no investigation. About a year later, a fiduciary purchased the land in his individual capacity. Emphasizing that a specific commitment to purchase would have been premature at the 1968 meeting, and that the fiduciary was the only director active in the business, the court held that the shareholders' inaction was not a rejection of the opportunity.[266]

At least one court does not require formal corporate action, but instead inferred the corporation's rejection and consent from the circumstances.[267] In *Lussier v. Mau-Van Dev., Inc.*, for example, the fiduciary advised the corporation at a shareholders' meeting of an opportunity to acquire land appropriate for commercial development.[268] The court concluded that the fiduciary had disclosed the opportunity, and that the shareholders' inaction on the opportunity, including their failure to object to the fiduciary's subsequent acquisition of the land, constituted implied consent.[269]

262. *See Klinicki*, 298 Or. at 682 n.13, 695 P.2d at 920 n.13 (1985) (indicating that an acceptance is invalid if it does not meet the ALI standards for formal directors' and shareholders' authorization; if the corporate acceptance is invalid the fiduciaries may take the opportunity only if the taking is fair to the corporation).

263. *See, e.g.*, Lindenhurst Drugs, Inc. v. Becker, 154 Ill. App. 3d 61, 70, 506 N.E.2d 645, 651 (1987); Imperial Group, Inc. v. Scholnick, 709 S.W.2d 358, 363 (Tex. Ct. App. 1986). For instance, without formal corporate action, the corporation's knowledge of both the opportunity and the fiduciaries' interest in it would not constitute corporate consent. *See* CST, Inc. v. Mark, 360 Pa. Super. 303, 309, 520 A.2d 469, 471-72 (1987) (without formal request for and receipt of corporate permission, fiduciary could not accept business opportunity for himself). Although the cases rarely address the issue, corporate acceptance may be unclear. Can acceptance be inferred, for example, or must it be authorized by formal action? Further, if acceptance is inferred, does the corporation retain its priority interest to the opportunity if it takes no steps to pursue the opportunity, or does the opportunity revert back to the fiduciaries after a certain lapse of time? To allow the corporation to retain its priority position for an unreasonable period seems inefficient and unfair to the fiduciaries, particularly if the fiduciaries also had legitimate rights to the opportunity.

264. 662 F.2d 371 (5th Cir. 1981).

265. *Id.* at 373.

266. *Id.* at 379.

267. *See, e.g.*, Lussier v. Mau-Van Dev., Inc., 4 Haw. App. 359, 369, 667 P.2d 804, 813 (1983).

268. From testimony of a shareholder:

> Question: Did you think that there should have been a shareholder's meeting called?
>
> Answer: I recall that we had one shareholders' meeting that Mr. Kainz stood up and said to the shareholders that parcels 19 and 20, the option is running out and if we can come up with the money then we should come up with it, otherwise he would go ahead with this new company.

Id. at 369, 667 P.2d at 813.

269. *Id.*

While the ALI provides a more detailed determination of corporate rejection than the cases, interpretational issues remain. The ALI states that the corporation may reject the opportunity through a vote of disinterested directors.[270] The directors' decision making would be subject to the standard of the business judgment rule.[271] In addition shareholders may reject the opportunity[272] if their action does not constitute a waste of corporate assets.[273]

In addition to formal directors' or shareholders' rejection under the ALI, the corporation apparently may impliedly reject an opportunity.[274] First, courts may infer a rejection from the circumstances. For example, the corporation's failure to accept promptly the opportunity after the fiduciaries' disclosure may constitute rejection.[275] Second, the directors' and shareholders' action may not comply with the specific ALI standards for formal corporate action,[276] but a valid rejection may still be implied.

An implied rejection is valid, however, only if it is fair to the corporation.[277] A rejection is fair if it complies with the standards used in evaluating transactions between fiduciaries and the corporation.[278] It is unclear, however, how courts will apply these standards. The standards emphasize whether the transactions have terms comparable to those in an arm's-length transaction with an unrelated third party.[279] The corporation's rejection of the opportunity is presumably fair if the corporation reasonably would have rejected the opportunity if offered by an unrelated third party. This determination seems highly speculative. In addition, some jurisdictions use a fairness test to resolve corporate opportunity disputes emphasizing a litany of factors dealing with the fiduciaries' conduct and the corporation's need for the opportunity.[280] This approach is markedly different from the fairness standard described above. This difference in standards unfortunately may confuse rather than elucidate a determination of what constitutes fair rejection.

The ALI also provides that the corporation may ratify[281] the fiduciaries'

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270. ALI Draft, *supra* note 25, §§ 5.05(a)(3)(B), 1.10.

271. ALI Draft, *supra* note 25, §§ 5.05(a)(3)(B).

272. ALI Draft, *supra* note 25, §§ 5.05(a)(3)(C), 1.11.

273. ALI Draft, *supra* note 25, §§ 5.05(a)(3)(C).

274. *See* ALI Draft, *supra* note 25, § 5.05(a)(3)(A) (this section does not require a formal rejection procedure).

275. ALI Draft, *supra* note 25, § 5.05(a) comment, at 109; *see also* Lussier v. Mau-Van Dev., Inc., 4 Haw. App. 359, 399-70, 667 P.2d 804, 813 (1983) (shareholders' failure to object to fiduciary's development of opportunity constitutes implied consent).

276. *See supra* text accompanying notes 270-73.

277. ALI Draft, *supra* note 25, § 5.05(a)(3)(A).

278. ALI Draft, *supra* note 25, § 5.05 & comment; *see id.* § 5.02 (further discussion of fairness standard). Neither § 5.05(a)(3)(A) nor the comments following define when a corporate rejection of an opportunity is fair. The comment to § 5.05(a), however, indicates that it would be appropriate to look to § 5.02 for guidance when there is a transaction between the fiduciary and the corporation. *Id.* § 5.05(a) comment, at 109; *see id.* § 5.02(a)(2)(A) comment, at 33-34 (useful when defining fairness as used in § 5.05 (a)(3)(A)).

279. ALI Draft, *supra* note 25, § 5.05(a)(3)(A).

280. *See supra* text accompanying notes 94-97 (discussion of fairness test used in corporate opportunity cases).

281. *See supra* note 25 (whether or not a corporation has accepted is not always clear).

taking of the opportunity if such ratification occurs after full disclosure and within a reasonable time after a suit challenging the taking of the opportunity is filed.[282] The corporation may ratify through either formal directors' or shareholders' action.[283]

V. ALTERNATIVE SOLUTION: PARTIES' REASONABLE EXPECTATIONS

This Article now explores an alternative to the traditional tests. Under this alternative, courts would resolve corporate opportunity disputes according to the expectations of the parties, as depicted in Figure 3.[284] This approach is in contrast to the traditional approach, which bases liability on the defendants' fiduciary status and the protection of the corporate interest. This proposal also differs from other expectation-related approaches, such as the *Lagarde* expectancy test,[285] the corporate expectations model,[286] and a model offered by Brudney and Clark.[287] Those approaches misconstrue the corporate-fiduciary

282. ALI Draft, *supra* note 25, § 5.05(c)-(d); *see supra* text accompanying notes 263-80 (standards and procedures for corporate rejection).

283. ALI Draft, *supra* note 25, § 5.05(c); *see also* Farber v. Servan Land Co., 662 F.2d 371, 379-80 (5th Cir. 1981) (illustrating how a court may scrutinize ratification); *In Re* Safety Int'l, 775 F.2d 660, 662 (5th Cir. 1985) (upholding informal ratification by defendant directors in their capacity as shareholders because defendants owned 100% of corporate stock). In *Farber*, 662 F.2d 371, at the 1970 annual shareholders' meeting, a shareholder raised the subject of the fiduciary's earlier acquisition of the land parcel adjacent to the corporation's property. According to the corporate minutes, the shareholders ratified the fiduciary's taking of the opportunity. *Id.* at 373. The court nonetheless questioned the ratification on two grounds. First, it queried whether the fiduciary's taking of the opportunity was the type of act the corporation could legally ratify. *Id.* at 379. Because the Florida courts had not indicated whether the shareholders could ratify a fiduciary's breach of duty, the *Farber* court left this query unresolved. *Id.* Second, the court found that even if shareholder ratification was possible, interested directors, acting in their shareholders capacity, may not ratify their own acts. *Id.* at 380. Thus, the fiduciary's voting of his shares, which constituted a majority of the stock, invalidated the ratification. *Id.*

284. Other disciplines have structured theories around parties' expectations. The economic theory of rational expectations posits that parties make economic decisions, particularly ones regarding pricing, in a rational and intelligent manner. At the time of the decision, they take into account all past, present, and anticipated future events and relevant information. For further discussion, *see* G. SHAW, RATIONAL EXPECTATIONS: AN ELEMENTARY EXPOSITION 46-56 (1984); S. SHEFFRIN, RATIONAL EXPECTATIONS (1983); Maddock & Carter, *A Child's Guide to Rational Expectations*, 20 J. ECON. LIT. 39, 41-42 (1982).

The psychology theory of expectancy posits that individuals consider the relationship between their efforts, performance, and outcome. For instance, the higher the expectancy that their efforts will affect their actual performance, the higher the expectancy that their performance will affect the ultimate outcome, and the higher the desirability of the outcome, the more motivation individuals will have to initiate and sustain efforts to achieve the outcomes. E. LAWLER, PAY AND ORGANIZATIONAL EFFECTIVENESS: A PSYCHOLOGICAL VIEW 87-92, 101-116 (1971); Lawler & Suttle, *Expectancy Theory and Job Behavior*, 9 ORGANIZATIONAL BEHAV. & HUM. PERFORMANCE 482-87 (1973).

285. *See supra* text accompanying notes 85-93.

286. *See supra* text accompanying notes 184-225.

287. Brudney & Clark, *supra* note 2, at 1011. Professors Brudney and Clark, propose a model they believe is consistent with the expectations of rational corporate entities. In closely held corporations, the model precludes the fiduciaries from pursuing an opportunity if: (1) the fiduciaries use corporate assets to acquire or develop that opportunity, (2) the opportunity is "functionally related" to the corporation's business and the fiduciaries have not obtained the corporation's consent, or (3) the corporation has an "interest or expectancy" in the opportunity and the fiduciaries have not obtained the corporation's consent. *Id.* at 1006. A "functionally related" opportunity is one in which the operations, such as manufacturing or sales, overlap those of the corporation's, so that the integration of the opportunity into the corporation would produce "non-trivial synergistic gains."

relationship and how corporations operate. Furthermore, they consider the corporation's interest predominant.

The proposed reasonable expectations test would protect the expectations of *both* the corporation and fiduciaries. The expectations of the parties, however, are not always easily discernible. The optimal situation is when the parties have an express agreement describing their expectations on the resolution of corporate opportunity disputes. As discussed later, an express agreement has numerous distinct advantages and should be encouraged.[288] Many corporations and fiduciaries, however, currently do not execute express agreements on this subject.[289] In the absence of an express agreement, the next best choice is for

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Id. at 1012. A corporation's expectancy is an amorphous concept that extends beyond contractually based rights. *Id.* at 1013-16. If there is no corporate consent, there is a presumption that the opportunity is functionally related to the corporation and the corporation has an expectancy in it. *Id.* at 1013, 1016.

In publicly owned corporations, the model prohibits an outside director only from using corporate resources, including information, to develop or acquire an opportunity. *Id.* at 1044. The model prohibits a full-time executive from taking any active business opportunities. *Id.* at 1023. By analogizing full time executives to trustees, Brudney and Clark argue that this categorical rule is justified because the shareholders of a public corporation cannot adequately select or monitor the "tendency of officers to divert corporate assets." *Id.* In addition, the officers' compensation is sufficient to induce their best efforts to the corporation, without adding covert compensation. *Id.*

These solutions pose a number of problems. First, the assumption that close corporations need less protection than public corporations is unjustified. The argument for lesser protection for close corporations is based on the presumption that fiduciaries in close corporations have a more consensual relationship with the corporation. *Id.* at 1003. It is as likely or more likely, however, that fiduciaries of public corporations have carefully negotiated written agreements with the corporation. *See supra* note 36. While the shareholders of public corporations do not directly negotiate with the fiduciaries, the board and corporate executives and counsel are sophisticated at negotiating terms that protect general corporate and shareholder interests. Shareholders already entrust these individuals with negotiating the overall employment relationship with fiduciaries, of which the subject of corporate opportunities should be a part. In addition, the diversion of a significant opportunity is more likely to harm significantly a small, single-business close corporation than a large, diversified public corporation.

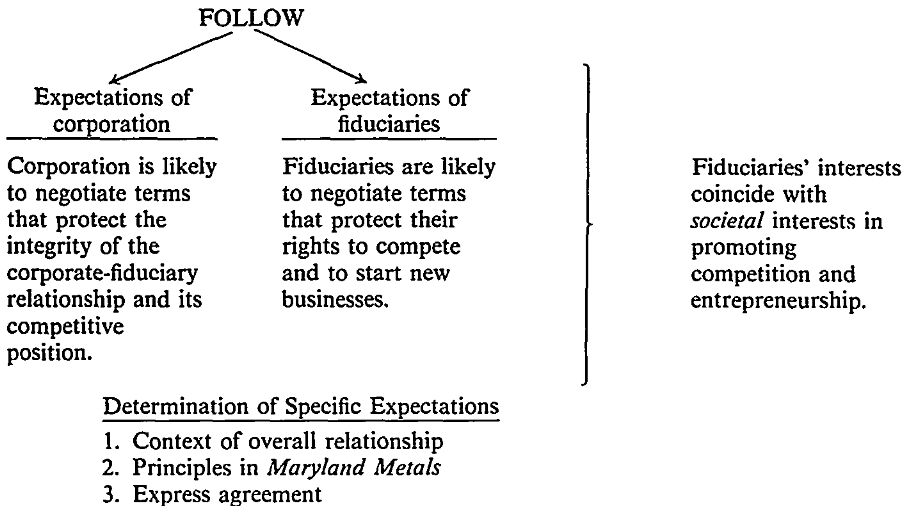
Second, the categorical rule denying all business opportunities to full-time executives in public corporations is an overbroad remedy. This result would be inconsistent with the corporation's and the fiduciaries' reasonable expectations, which would envision a more balanced resolution. A categorical rule would be particularly surprising and unfair to fiduciaries with noncompetition covenants who discover that compliance with the designated terms of that provision would not protect them from being precluded from a competing business opportunity under the corporate opportunity doctrine. While Brudney and Clark predicate their rules on a trustee relationship, the parties are more likely to characterize their relationship as one of agency. *See supra* text accompanying notes 34-40. In addition, Brudney and Clark argue there are no "compelling" reasons not to apply a categorical rule. Brudney & Clark, *supra* note 2, at 1028-30. They do not explicitly acknowledge significant individual and societal interests, however, which as this Article documents, do offer "compelling" reasons for a more balanced approach.

Finally, Brudney and Clark's distinction between full-time executives and outside directors is questionable. Their model imposes fewer restrictions on outside directors because they are not highly compensated. *Id.* at 1042-43. The model also favors outside directors because of the belief that they offer an independent and unbiased view that promotes proper conduct of the board. Thus, the corporation's efforts at attracting these individuals to their boards of directors is a worthy goal. Empirical studies, however, have discounted both of these rationales. A survey has indicated that outside directors in large corporations receive an average generous compensation of $32,924 for each directorship. HEWITT ASSOC., *supra* note 37, at 5-6. Other research finds that the presence of outside directors on boards actually increases the probability of illegalities. Gautschi & Jones, *Illegal Corporate Behavior and Corporate Board Structure*, in 9 RESEARCH IN CORPORATE SOCIAL PERFORMANCE AND VALUES, *supra* note 34, 93.

288. *See infra* text accompanying notes 332-39.

289. *See supra* note 36.

FIGURE 3. PARTIES' REASONABLE EXPECTATIONS



the courts to follow the reasonable expectations of the parties if they had negotiated the issue at the outset of their relationship.

While this process inherently includes some speculation, courts can use guidelines to ensure that the outcomes are generally predictable. First, the courts should begin with an understanding of the basic relationship between the corporation and fiduciaries. Analogizing current fiduciaries to trustees or even to the historically rigid fiduciary role is outdated. As previously discussed, the corporate-fiduciary relationship is more analogous to an agency, employee, or partnership relationship where the duties and rights of both parties are recognized and flexibly negotiated.[290] The courts should respect their understanding.

Furthermore, if the parties had negotiated a corporate opportunity provision, they would have been in positions to negotiate terms in their own best interests. Their relative parity[291] helps ensure that the agreement fairly accommodates the corporation's and the fiduciaries' interests. The corporation would negotiate terms that protect the integrity of the corporate-fiduciary relationship and the corporation's competitive position. The fiduciaries would negotiate terms that protect their right to compete and to start new businesses. Society's interest in promoting competition and entrepreneurship efficiently coincides with the fiduciaries' interests. Thus, the agreement accommodates both corporate and noncorporate interests.

Other guidelines for the courts are the principles set forth in *Maryland Metals, Inc. v. Metzner*.[292] *Maryland Metals* is one of the exceptional cases where

290. *See supra* text accompanying notes 31-37.

291. To the extent courts apply the doctrine to lower level "key employees," these "fiduciaries" may not be comparably sophisticated or be in parity with the corporation.

292. 282 Md. 31, 382 A.2d 564 (1978).

the court took the bold step of explicitly recognizing competing corporate and noncorporate interests in a corporate opportunity dispute. The case does not explore exactly how these interests are triggered, but it offers nonetheless a useful initial framework on which to analyze properly these disputes.

A. Maryland Metals *and* Science Accessories

In *Maryland Metals* the Kerstein family had owned a scrap metals processing business since the 1930s.[293] Sidney Metzner joined the business in 1951, played a key role in its development, and had risen to the position of executive vice president. Metzner was asked to investigate a certain technologically advanced scrap processing machine know as a "shredder." Over seven years, Metzner prepared several studies on the machinery and repeatedly recommended that the corporation purchase it. The corporation, however, repeatedly deferred any purchase.

In the fall of 1973 Metzner and Sellers, another key employee, approached corporate president Kerstein about an equity interest in the corporation, or, in the alternative, that they and the corporation form a new business using the shredder. Kerstein denied their requests. Shortly thereafter, Metzner and Sellers began actively preparing for their departure from the corporation and for the establishment of a competing business. They contacted prospective investors, met with various municipal agencies, applied for a loan, secured an option on a piece of land, contracted to purchase a shredder, and took numerous steps to prepare the site and equipment for business.[294] The fiduciaries concealed all of these preparatory steps from the corporation. In May 1974 the fiduciaries left the corporation. The bank approved the loan, Metzner and his associate exercised the option to purchase the land, and in March of the following year they opened their business.[295] The corporation subsequently claimed that the fiduciaries' conduct, including the starting of their new business, violated, among other fiduciary duties, their duties under the corporate opportunity doctrine.[296]

These facts illustrate the interconnection of corporate, individual, and societal interests. The corporation had a legitimate interest in the integrity of the corporate-fiduciary relationship. The corporation wanted to be able to trust the fiduciaries with extensive business information and to feel that the fiduciaries would carry out their executive decision making responsibilities with the corporate interest in mind. At the corporation's request, the fiduciaries gathered information on the shredder and prepared reports compiling their findings. The corporation also had an interest in the business and profits that it would have obtained if the fiduciaries had not started a competing business.[297]

293. *Id.* at 33-35, 382 A.2d at 571.

294. *Id.* at 43, 382 A.2d at 571.

295. *Id.* at 48, 382 A.2d at 573-74.

296. *Id.* at 37, 382 A.2d at 567.

297. The opportunity, however, was not unique; the corporation could buy a shredder if it wished. Thus, the corporation could have improved its competitive position by buying its own shredder and consequently could diminish the amount of alleged lost profits. The corporation, however, repeatedly declined to purchase the shredder; it apparently questioned the shredder's commer-

The facts also illustrate individual and societal interests. For example, after years of conscientious service as employees, the fiduciaries wanted an ownership role in the corporation. When the corporation denied them that role, the fiduciaries proposed a joint venture with the corporation. Only when the corporation also rejected that idea did the fiduciaries decide to pursue their entrepreneurial interests through their own business. The fiduciaries were not motivated by a desire to harm the corporation, but rather by a desire to develop a business that, at least in part, belonged to them.

Furthermore, denying the opportunity to the fiduciaries would have drastic consequences for the fiduciaries, especially Metzner. Because he had been with the corporation for over twenty years, his knowledge and skills were probably limited to the scrap metals processing business. Extrapolating these skills and knowledge to a new industry would have been difficult; starting a new career in another industry and developing the requisite new expertise would be costly and disruptive.

Despite the existence of these noncorporate interests in *Maryland Metals*, the traditional tests do not explicitly acknowledge or consider them. Under the line of business test, for example, courts would simply preclude the fiduciaries from the opportunity because the new company clearly was in competition with the corporation.[298] Under the expectancy test, courts would find that the corporation's rights extend only to opportunities to which it has a contractual claim.[299] Because there was no such contract right, these courts would allow the fiduciaries to pursue the opportunity. The emerging models also would not acknowledge the noncorporate interests. The corporate capability model would question the corporation's financial ability to develop the opportunity,[300] while the disclosure model would find the fiduciaries liable because they did not fully disclose their intentions to the corporation.[301]

In contrast, *Maryland Metals* took a more balanced approach that reflects sound judicial reasoning. In determining whether the fiduciaries breached their duties either during or after their tenure with the corporation, the court interwove discussions of the corporate opportunity doctrine and employment noncompetition laws.[302] The decision began with an explicit recognition of competing policy interests: the corporation's concern about the integrity of the corporate-fiduciary relationship versus society's and the individual's interest in fostering free competition.[303] The court's accommodation of these competing

cial benefits and was concerned about the financial commitment the shredder would require. *See id.* at 31, 382 A.2d at 566-67.

298. *See supra* text accompanying notes 71-78.

299. *See supra* text accompanying notes 88-90.

300. *See supra* note 140 and accompanying text.

301. *See supra* text accompanying notes 226-30.

302. *Maryland Metals*, 282 Md. at 34, 382 A.2d at 566-67. The court's interweaving of the two areas of law may cause some to question whether the court's articulation of noncorporate competing interests was clearly intended to apply to the corporate opportunity doctrine. *But see* Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962-63 (Del. 1980) (citing *Maryland Metals* as directly applicable to a corporate opportunity dispute).

303. *Maryland Metals* reads:

policy interests was consistent with employment noncompetition laws but was a novel approach for the corporate opportunity doctrine.[304]

In considering these competing interests, the court applied several principles. During their tenure, fiduciaries should fulfill their responsibilities diligently and in good faith.[305] While they cannot actively and directly compete with the corporation, fiduciaries have a privilege to prepare and to make arrangements to compete with the corporation prior to their departure.[306] This privilege, however, is negated if they commit patently wrongful acts,[307] such as fraud or misappropriation of the corporation's trade secrets or proprietary confidential information.[308] If fiduciaries do not commit these wrongful acts and have not signed disclosure agreements, they have no obligation to disclose their plans.[309] To require disclosure of the details of their plans would render "practically meaningless" their privilege to prepare and would constitute an "unjustifiable infringement" upon the individuals' right to select their employment and an "undesirable impediment to free competition."[310]

After their departure from the corporation, the court continued, fiduciaries can compete actively.[311] They can use the general expertise and knowledge obtained from their corporate experience.[312] Although the fiduciaries' competing

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> Because corporate managerial personnel enjoy a high degree of trust and confidence in performing their assigned functions, a potential exists for serious abuses of confidentiality whenever personnel attempt to aggrandize their own economic interest at the expense of the employer. . . .
>
> This concern for the integrity of the employment relationship has led courts to establish a rule that demands of a corporate officer or employee an undivided and unselfish loyalty to the corporation.

Maryland Metals, 282 Md. at 37-38, 382 A.2d at 568.

Not limiting its analysis to this consideration the court continued:

> The second policy recognized by the courts is that of safeguarding society's interest in fostering free and vigorous competition in the economic sphere. Thus, as Judge Openheimer stated for this court in *Operations Research v. Davidson*, 241 Md. 550, 575, 217 A.2d 375, 389 (1966): "[I]t is important to the free competition basic to our national development as well as to the individual rights of employees who want to go into business for themselves that their spirit of enterprise be not unduly hampered."

Id. at 38-39, 382 A.2d at 568-69.

304. Under employee noncompetition laws, in the absence of a covenant, employees can enter a competing business upon termination of their employment. During their tenure, they may make limited preparations for entering into such a business. *See* Lynch v. Patterson, 701 P.2d 1126, 1135 (Wyo. 1985); Harty, *Competition Between Employer and Employee: Drafting and Enforcing Restrictive Covenants in Employment Agreements*, 35 DRAKE L. REV. 261, 263-68 (1985-86); Rubin & Shedd, *Human Capital and Covenants Not to Compete*, 10 LEGAL STUD. 93, 100 (1981). *See generally* Comment, *Post Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 705-06 (1985) [hereinafter cited as Comment, *Post Employment*] (discussion of reasonableness test of post employment restraints); ALI Draft, *supra* note 25, § 5.06 comment g (providing that if fiduciaries are not found liable under the corporate opportunity model, they may not pursue the opportunity if it violates the noncompetition rules).

305. *Maryland Metals*, 282 Md. at 38, 382 A.2d at 568.

306. *Id.* at 39-40, 382 A.2d at 568-69.

307. *Id.* at 44, 382 A.2d at 566.

308. *Id.* at 40, 44, 382 A.2d at 569, 572.

309. *Id.* at 40, 382 A.2d at 569.

310. *Id.* at 47-48, 382 A.2d at 573.

311. *Id.* at 38, 382 A.2d at 568.

312. *Id.* at 43, 48, 382 A.2d at 571, 573-74.

enterprise may harm the corporation, their "business energy and initiative" after they leave the corporation is "not synonymous with treachery" during their tenure.[313] Applying these principles to the facts, the court concluded that the fiduciaries did not breach their duties.[314]

Science Accessories Corp. v. Summagraphics Corp.,[315] a Delaware Supreme Court case, cited with approval *Maryland Metals*' articulation of competing policy interests.[316] The corporation in *Science Accessories* manufactured digitizers, electronic devices used in the computer graphics field. Defendants—one in charge of the research and development and engineering departments, one a chief engineer, and one a supervisor of manufacturing—were key employees rather than traditional fiduciaries.[317] While employed at the corporation, defendants learned of innovative technology conceived by a Dr. Alfred Brenner, who was unrelated to the corporation. The commercial use of the technology would produce a new product that would be more operationally reliable and less expensive to manufacture than the digitizer which the corporation manufactured—in short, a superior substitute product both to manufacture and to use.[318]

On their own time, off the corporation's premises, and without the use of corporate materials, defendants built a working model of the new product. While defendants did not use the corporation's materials for building the product model, they did use about thirty dollars worth of materials and telephone calls for activities related to the opportunity. It is unclear if the defendants, in conjunction with Dr. Brenner, began production in their new company, Summagraphics, during defendants' employment with the corporation. They clearly took definitive steps toward the company's formation, including the limited circulation of a prospectus prior to their departure.

Defendants apparently did not disclose the new product idea or any of their activities to the corporation.[319] The fiduciaries argued that they were subject to a confidentiality agreement with Dr. Brenner, who did not want the corporation to know or exploit this technology.[320] In addition, the corporation was in poor financial condition. The corporation argued that development of the new product was a corporate opportunity and that the defendants' nondisclosure and pursuit of it constituted a breach of their fiduciary duty.[321]

In resolving the dispute, the *Science Accessories* court viewed the corporate opportunity doctrine as an extension of agency principles,[322] indicating that the principles are applicable not only to traditional fiduciaries but also to "key man-

313. *Id.* at 46, 382 A.2d at 572.
314. *Id.* at 48, 382 A.2d at 573-74.
315. 425 A.2d 957 (Del. 1980).
316. *Id.* at 963 (citing *Maryland Metals*, 282 Md. at 38, 382 A.2d at 568).
317. *Id.* at 960.
318. *Id.*
319. *Id.* at 964.
320. *Id.* at 962, 964.
321. *Id.* at 961-62.
322. *Id.*

agerial personnel."[323] In determining whether defendants' conduct during their corporate tenure violated their duty, the court followed the basic principle in *Maryland Metals*: fiduciaries have the right to prepare to compete with their corporation, so long as they have not committed such wrongful acts as misappropriation of proprietary information or premature solicitation of customers.[324] Noting that defendants' conduct was "not above reproach," and commenting in particular on defendants' unfavorable comparison in the new company's prospectus of the corporation's product with the new company's product,[325] the court nonetheless found that the conduct was not of the egregious nature that would invalidate the fiduciaries privilege to make business preparations.[326] The court instead permitted the corporation to assess costs against defendants for their limited use of corporate materials and facilities, concluding that there were no "actual" damages from any of defendants' other activities.[327] Finally, because the defendants were not subject to noncompetition covenants, they were free to compete actively with the corporation after their corporate tenure.[328]

In determining whether defendants breached any duty by their nondisclosure, the court emphasized the corporation's capabilities.[329] It found that Dr. Brenner's unwillingness to disclose or work with the corporation and the corporation's poor financial condition were sufficient bases for concluding that the opportunity was unavailable to the corporation and thus not one to which the corporation had any priority rights.[330] Because the opportunity did not belong to the corporation, defendants had no disclosure obligations regarding it.[331]

The reasoning and conclusions of *Maryland Metals* and *Science Accessories*

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323. *Id.* at 962. The court's opinion does not indicate whether the individuals had notice of their fiduciary roles. If the corporation had expressly asked defendants to assume the traditional fiduciaries' positions or told defendants that their positions were of a fiduciary status, knowledge of the potential restrictions on their entrepreneurial interests may have discouraged defendants from accepting the positions, encouraged them to renegotiate the terms of their employment, or prompted them to consider quitting.

324. *Id.* at 965.

325. *Id.*

326. *Id.*

327. *Id.* at 965, 967.

328. *Id.* at 965.

329. *Id.* at 963.

330. *Id.*

331. *Id.* at 964. Although the court did not articulate particular societal interests, several facts may have influenced the decision. First, the fiduciaries wanted to commercialize a product based on innovative and improved technology. The success of their venture, therefore, would not only increase competition but also contribute a technologically improved and advanced product to the marketplace. Second, at the start-up stage fiduciaries are often more adept and successful at managing and developing entrepreneurial projects than established corporations. In *Science Accessories*, the fiduciaries' comparative advantage would seem especially pronounced because the corporation's financial ability to pursue the opportunity was uncertain. *See id.* at 963. Because the corporation generally was unwilling to develop ideas proposed by these fiduciaries, and the inventor of the new product was unwilling to work with the corporation, the parties most receptive and committed to developing the opportunity together were the fiduciaries and the inventor offering the opportunity. *See id.* Third, the inventor's particular confidence in the fiduciaries gave the fiduciaries an advantage over random third parties as well as the corporation. The fiduciaries also shared cumulative technical engineering and manufacturing knowledge and experience in the computer graphics industry that put them in a select if not unique position.

consider both corporate and noncorporate interests and are consistent with the reasonable expectations of the parties. In the absence of an express and clearly defined agreement, the principles of these cases offer appropriate guidelines for resolving future disputes.

B. *Resolving the Dispute Through Contract*

An express agreement between the corporation and fiduciaries regarding opportunities that may be of interest to both of them offers significant advantages.[332] First, fiduciaries and the corporation commonly execute agreements describing their respective obligations and rights. By including terms that address corporate opportunities in their typical negotiating process, the parties would provide a more comprehensive description of their understanding. As knowledgeable parties with relative parity, they are likely to negotiate arrangements that are efficient, fair, and address their major concerns.

In addition, a contract negotiated in anticipation of possible corporation opportunity disputes allows the parties to reflect carefully about what a fair and well-reasoned resolution would be. Courts currently try to resolve corporate opportunity disputes after the fiduciaries have successfully developed the opportunity. At that point, fiduciaries have much to lose and the corporation has much to gain. The high stakes may fuel emotions and blur memories of the events leading to the dispute.

Moreover, an express agreement that is fairly negotiated and clearly delineated enhances the integrity of the corporate-fiduciary relationship. The parties do not have to speculate about what is expected of each; the certainty created by the contract provides guidelines on which they can base their conduct. This understanding allows the parties both to carry out their responsibilities without unnecessary delays or ambiguities and to proceed with confidence, without having to second-guess the other party's actions. Such an agreement lays the foundation for a constructive and cooperative relationship. Advance and open communication between the fiduciaries and corporation can prevent misunderstandings, resentment, and disputes, and allows the parties to tailor creative provisions. For example, specifying remedies that more accurately reflect the harm incurred by the parties,[333] instead of the all-or-nothing constructive trust remedy,[334] may yield fairer treatment. Designing solutions that incorporate the in-

332. *See* ALI Draft No. 7, *supra* note 244, at § 5.09 (providing that corporations can establish a policy and standards dealing with corporate opportunities). Although the corporation and fiduciaries may agree on noncompetition covenants, provisions regarding corporate opportunities per se are highly unusual. This suggests that either the parties have an implicit agreement not disclosed in their written agreement or they truly have no agreement on the issue. Rational expectation economists would argue that the parties do not make systematic errors. *See supra* note 284. Hence, they must have an implicit agreement regarding corporate opportunities because completely ignoring the issue would be a systematic error. One type of implicit agreement would be that, in light of unforeseeable future events, the parties would agree only to act in good faith and to deal fairly.

333. Under certain circumstances, for example, the fiduciaries may return the opportunity to the corporation in exchange for a cash payment for their equity investment or the fiduciaries may keep the opportunity but pay the corporation for any use of corporate resources and actual harm the corporation incurred.

334. *See supra* text accompanying note 21.

terests of both parties, such as jointly developing the opportunity,[335] may offer the most efficient and productive answer.

A contract should clearly delineate the parties' agreements in the following areas:[336]

(1) what opportunities are at issue;

(2) who is subject to the contract terms and for what specific durations;

(3) the fiduciaries' disclosure requirements, including which opportunities must be disclosed, when they must be disclosed, and to whom they must be disclosed;

(4) the corporation's disclosure requirements (e.g., corporation's lines of business) and obligations after the fiduciaries' disclosure (e.g., affirmative duties to investigate and pursue opportunities or to return opportunity to fiduciaries);

(5) what constitutes corporate approval or rejection;

(6) existing or future opportunities to which either the corporation or the fiduciaries are waiving their rights (e.g., opportunities in which the fiduciaries have agreed to represent and bargain on behalf of the corporation);

(7) relationship between any noncompetition covenants and provisions dealing with corporate opportunity;[337]

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335. The cases seem to presume that the only two options for developing an opportunity are development by the corporation or development by the fiduciaries. In addition, however, an unrelated party could develop the opportunity, or it could not be developed at all. There is also the possibility that the corporation and the fiduciaries could jointly develop the opportunity. They may implement this joint development through a variety of arrangements. The fiduciaries could remain with the corporation but independently manage the opportunity and share in its profits. Or the fiduciaries may establish their own company, which then becomes a partner with the corporation in a joint venture created specifically to develop the opportunity. Finally, the fiduciaries may establish their own company in which the corporation invests or from which the corporation benefits in some way, for example, as a licensee of the company's products, services, or technology.

336. While courts should generally enforce agreements in the corporate opportunity area, courts may want to impose appropriate limits on their enforceability. One appropriate limitation may be that the agreements are enforceable only if they are fair to the corporation's interest and do not impose unreasonable burdens on the fiduciaries. Fairness to the corporation could be determined by the following types of inquiries: (1) Viewed in its entirety, including the corporate opportunity provisions, does the agreement between the corporation and the fiduciaries reflect a comparable exchange of value? (2) Is there reasonably foreseeable harm to the corporation or is such harm outweighed by benefits that the corporation may reasonably expect? (3) Are shareholders' and directors' approval obtained or required? These inquiries are analogized from duty of loyalty principles in conflict of interest cases. *E.g.*, Schlensky v. South Parkway Bldg. Corp., 19 Ill. 2d 268, 166 N.E.2d 793 (1960); ALI Draft, *supra* note 25, § 5.06 (regarding noncompetition rules). This approach would marry principles from the general duty of loyalty doctrine that protects the corporation's and shareholders' legitimate interests, to principles of employment noncompetition laws that consider individual and societal concerns; *see supra* note 304.

The careful scrutiny of employee noncompetition covenants is not appropriate here. A major rationale for the careful scrutiny of employee noncompetition covenants is that employees are unsophisticated and in a disadvantageous bargaining position relative to the corporation so that terms are more likely to be unfair to the employee. Comment, *Post Employment*, *supra* note 304, at 705-06. This rationale is not descriptive of the typical corporate-fiduciary relationship, since both parties tend to be comparably sophisticated and have relative parity in bargaining positions.

337. Employee noncompetition covenants are designed specifically to limit employees' access to opportunities that are competitive with the corporation. While corporate opportunity provisions likely will define "opportunities" to include competing opportunities, these provisions also may include noncompeting opportunities. For example, the parties may negotiate that fiduciaries must

(8) possibility of cooperative or joint development of the opportunities and under what circumstances such development would occur; and[338]
(9) remedies for a violation of the agreement terms.[339]

As with all unchartered waters, corporations and fiduciaries may find it difficult to navigate through their initial experiences in negotiating corporate opportunity provisions. For example, the corporation may have difficulty in anticipating the opportunities in which it may have a future interest. The corporation thus may negotiate its scope of interest in very general terms. While more specific terms would better guide the parties, general provisions still offer evidence of the parties' reasonable expectations. A second problem may occur in close corporations where the fiduciaries themselves may be asked to determine the corporation's policy on corporate opportunities. Their conduct and the contents of the policy later may be scrutinized for a possible breach of their fiduciary duties. The advantages of an express agreement, such as the enhancement of the integrity of the corporate-fiduciary relationship, however, would appear to outweigh these problems.

VI. Conclusion

Current corporate opportunity doctrine governs disputes between fiduciaries and the corporation that arise when the fiduciaries pursue business opportunities that the corporation claims belong to it. These disputes trigger different and often competing interests, such as the corporation's interest in the integrity of the corporate-fiduciary relationship, the fiduciaries' interest in their ability to compete with the corporation, and society's interest in promoting competition and the starting of new businesses.

In resolving these disputes, the traditional tests explicitly consider only the corporation's interests, ignoring competing individual and societal concerns. A study of the cases of the last decade reveals three evolving models to resolve these disputes: the corporate capability model, the corporate expectations model, and the disclosure model. While these models have certain advantages, they are inadequate because, like the traditional tests, they consider only the corporation's interests.

The corporate opportunity doctrine can better reflect current policy concerns if it explicitly considers the legitimate interests of individuals and society, as well as of the corporation. This explicit recognition of competing interests, as illustrated in a few exceptional cases, is consistent with the fundamental understanding and expectations of the corporation and its fiduciaries. The Article recommends that the corporation and fiduciaries expressly negotiate the terms under which they will resolve corporate opportunity disputes. This ensures that the concerns of the corporation and the fiduciaries are addressed, while adding

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disclose their interest in opportunities that are offered to the corporation and the corporation is considering actively—even though the opportunities clearly are unrelated to the corporation's current business activities.

338. *See supra* note 335.

339. *See supra* note 333.

certainty to an area plagued by ambiguities and confusion. In the absence of an express agreement, the courts should enforce the reasonable expectations of the corporation and the fiduciaries.