Pace Law Review

Volume 23
Issue 1 *Winter 2002*

Article 3

January 2002

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I. INTRODUCTION

In this era of rapid technological innovation, business entities face many exciting corporate opportunities. These business entities, however, may not be prepared to exploit new corporate opportunities that they encounter. A business's inability to immediately take advantage of profitable opportunities understandably tempts fiduciaries within these entities, who learn of the opportunities through their employment, to consider personally taking the opportunities. But the common law corporate opportunity doctrine may prevent a fiduciary from taking and developing business opportunities even though his business cannot or is not prepared to exploit the opportunities.

As purposely stated above, the corporate opportunity doctrine may, not necessarily will, prevent a fiduciary from personally developing corporate opportunities because it is not clear in many jurisdictions what constitutes a corporate opportunity. It is even less clear what constitutes an illegal usurpation, or taking, of a corporate opportunity, which violates a fiduciary's duty of loyalty.

The disordered landscape of corporate opportunity law suggests that a clear, uniform statute should be adopted by the states to afford fiduciaries a semblance of predictability across jurisdictions. The statute should retain a relatively strict adherence to the duty of loyalty, while not preventing fiduciaries from taking opportunities that a business cannot reasonably exploit when presented. As developed below, the statute rejects strict bright-line rules, but also eliminates any judicial inquiry into the inherent fairness of a fiduciary's conduct.

The strict corporate opportunity tests unduly inhibit the efficient development of corporate opportunities because a fiduciary must either completely refrain from taking any business opportunity or must first offer the opportunity to his business and obtain the business's consent. The fairness tests, moreover, fail to promote predictability because they give judges, mostly state appellate judges, too much discretion to decide cases on fact-specific equitable considerations.

Part II of this Article briefly discusses the fiduciary duty of loyalty and the development of the corporate opportunity doctrine. The current corporate opportunity tests and defenses, which are applied by courts to determine whether a fiduciary is liable under the doctrine, are also examined. The tests and defenses are few, but courts have created certain nuances within the general tests that will be explored.

Part III proposes a model corporate opportunity statute. First, the statute rejects the view that public business entities should be treated differently from closely held entities because such a distinction is unnecessary as it adds a layer of confusion to a court's analysis and, in most cases, is not applicable to the analysis. It will not be applicable because most corporate opportunity claims arise in closely held entities.

Second, the statute rejects by omission the strict views of the doctrine, which posit that a fiduciary must never personally take an opportunity or that she must first disclose the opportunity to her business before pursuing the opportunity. These strict views inhibit allocative efficiency and innovation because, although a business may not be able to take initially an opportunity because of financial reasons, it may sit on the opportunity until it believes it can profitably exploit the opportunity. In the meantime, the business opportunity may be lost to a competitor or may disappear altogether. The proposed statute rejects strict disclosure and permits a fiduciary to take an opportunity without notifying the business. The danger for the fiduciary, however, is that although the initial burden of showing a corporate opportunity is placed on the business, its burden, in many cases, will easily be met.

Under the proposed statute, a business will be able to establish the existence of a corporate opportunity by satisfying the criteria for establishing a corporate opportunity under any of the current tests. Consequently, in many cases, the burden of persuasion will shift to the fiduciary and she will have to establish by clear and convincing evidence that the business (1) consented to the fiduciary's taking before the fiduciary proceeded; (2) was initially unable to take the opportunity because of financial constraints; or (3) ratified the taking of the opportunity after it learned of the fiduciary's conduct. Finally, the proposed statute purposefully omits several fiduciary defenses that do not promote allocative efficiency and economic innovation, are not consistent with a hypothetical contract theory of the duty of loyalty, or are so inherently amorphous that they reduce predictability under the doctrine.

Part IV discusses the proposed statute in detail focusing on how rejection of the strict tests will promote greater flexibility for fiduciaries to take opportunities their entities are not financially able to exploit. Recognizing the nature of business in the information age, this flexibility again seeks to promote allocative efficiency and economic innovation. Part IV also focuses on why the financial inability defense is retained in the proposed statute. The financial inability defense is maintained for the same reasons the strict tests are discarded. This defense enables a fiduciary to exploit efficiently opportunities that her business is unable to exploit. Moreover, such a defense is consistent with a hypothetical contract theory of the fiduciary duty of loyalty, which examines what the parties would have expressly contracted for if the issue were contemplated before the fiduciary's employment. Finally, Part IV contends the fairness tests, utilized by several courts, are intellectually unsatisfying in our relatively ordered economic system. Fairness tests create uncertainty for both entities and fiduciaries, and are, therefore, rejected.

II. THE CORPORATE OPPORTUNITY DOCTRINE AND ITS TESTS AND DEFENSES

The corporate opportunity doctrine and the duty of loyalty are intertwined to the extent that courts created the corporate opportunity doctrine to enforce a fiduciary's duty of loyalty to her business.[1] The duty of loyalty mandates that a fiduciary must act in the interests of her business; however, such a duty does not rise to the level of duty inherent in a principal/agent relationship.[2] To enforce a fiduciary's duty of loyalty, courts have created or adopted several tests to (1) establish whether an opportunity taken by a fiduciary is a corporate opportunity; and (2) determine whether the fiduciary breached her duty of loyalty by taking the opportunity.[3] Although most courts merge the two inquiries into one corporate opportunity analysis,[4] both are distinct inquiries, and, therefore, will be examined as separate and independent inquiries during this Article's evaluation of the current tests.

A. *The Duty of Loyalty as a Gap-Filling Measure in Fiduciary Contracts*

As a brief introduction, this section examines the scope of the duty of loyalty in relation to the corporate opportunity doctrine. The duty of loyalty in the corporate opportunity context restricts the ability of a fiduciary to usurp corporate opportunities that come to her during her employment with a business. As a general rule, courts that find violations of the duty of loyalty (and, consequently, violations of the corporate opportunity doctrine) impose a constructive trust on the proceeds of the unlawfully taken opportunity.

More importantly, this section discusses and proposes a contractual theory of the duty of loyalty on which this Article's proposed statute is anchored. Specifically, the proposed statute accepts two controversial assumptions concerning the duty of loyalty in the corporate opportunity context. First, the duty of loyalty is, and should be, enforced by courts as an implied term

1. *See infra* Section A of Part II.
2. *See infra* Section A of Part II.
3. *See infra* Section B of Part II.
4. *See infra* Section B of Part II.

of a fiduciary's contract with her business. Therefore, the duty of loyalty should be used as a gap-filling measure inserted and enforced by courts *ex post* to satisfy the probable implied *ex ante* intentions of the parties to the fiduciary contract. Second, because the duty of loyalty is, and should be, a judicially applied gap-filler, the parties to fiduciary contracts may modify or waive the duty of loyalty in all or some circumstances by entering into express agreements defining the scope of the fiduciary's duty of loyalty.

1. *The Corporate Opportunity Doctrine and the Duty of Loyalty*

Under the common law and most, if not all, state business organization statutes, "[c]orporate officers and directors bear a duty of loyalty to the [business] they serve"[5] and "[t]he doctrine of corporate opportunity represents but one species of the broad fiduciary duties assumed by a corporate director or officer."[6] "[O]ut of this relationship arises a duty of reasonably protecting the interests of the [business]."[7] "Accordingly, [a fiduciary] may not profit personally at the expense of the [business]. . . . If he does so profit, he may be held to be a trustee, as to those profits, for the benefit of the corporation."[8] In other words, if a fiduciary breaches his duty of loyalty to his business, the corporate "opportunity and any property or profit acquired [by the fiduciary] becomes subject to a constructive trust for the benefit of the

5. Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1148 (Me. 1995).

6. Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 154 (Del. 1995); *see also* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("The rule, referred to briefly as the rule of corporate opportunity, is merely one of the manifestations of the general rule that demands of an officer or director the utmost good faith in his relation to the corporation which he represents.").

7. Durfee v. Durfee & Canning, Inc., 80 N.E.2d 522, 527 (Mass. 1948); *see also* Schildberg Rock Products Co. v. Brooks, 140 N.W.2d 132, 136 (Iowa 1966); Maryland Metals, Inc. v. Metzner, 382 A.2d 564, 568 (Md. 1978) ("[The] 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."); Lutherland, Inc. v. Dahlen, 53 A.2d 143, 147 (Pa. 1947) ("[Officers and directors] must devote themselves to the corporate affairs with a view to promote the common interests and not their own, and they cannot, either directly or indirectly, utilize their position to obtain any personal profit or advantage other than that enjoyed also by their fellow shareholders.") (citation omitted).

8. Chem. Dynamics, Inc. v. Newfeld, 728 S.W.2d 590, 592-93 (Mo. Ct. App. 1987).

[business]."[9] Punitive damages also may be available to a prevailing plaintiff in some states.[10]

Under modern business organization statutes, the duty of loyalty is codified and represents a substantive and important limitation on fiduciary conduct to address a perceived vulnerability of principals to the "unfaithful" conduct of their fiduciaries. The duty of loyalty, therefore, enforces a simple proposition: that fiduciaries are to put the interests of their business before their private entrepreneurial interests while they serve as fiduciaries.

2. *The Hypothetical Contract Model and Fiduciary Duty*

As an outgrowth of the law-and-economics movement, many courts and commentators have accepted the proposition that one of the functions of contract law is to complete agreements between parties by inserting missing terms into the parties' contract *ex post*.[11] Judge Richard Posner, one of the preeminent advocates of applying the laws of economics to legal issues, notes that this *ex post* judicial interpolation of contract clauses reduces the cost of contracting (thereby increasing economic efficiency) because parties have difficultly contemplating every possible circumstance that could arise during their mutual performance:

> The longer performance will take—and bear in mind that in performance we must include the entire stream of future services that the exchange contemplates—the harder it will be for the parties to foresee the various contingencies that might affect performance . . . . [S]ome contingencies, even though foreseeable in the strong sense that both parties are fully aware that they may occur, are so unlikely to occur that the costs of careful drafting to

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9. Miller v. Miller, 222 N.W.2d 71, 78 (Minn. 1974) (citation omitted); *see also* Burg v. Horn, 380 F.2d 897, 899 (2d Cir. 1967) (applying New York law); Lagarde v. Anniston Lime & Stone Co., 28 So. 199, 201 (Ala. 1900); Note, *Corporate Opportunity in the Close Corporation—A Different Result?*, 56 GEO. L.J. 381, 382 (1967); Note, *Corporate Opportunity*, 74 HARV. L. REV. 765, 765 (1961). Although the proposed statute does not adopt a particular remedy, a constructive trust remedy also may lead to over-deterrence of independent fiduciary economic activity because of its all-or-nothing application.

10. *See generally* Longwell v. Custom Benefit Programs Midwest, Inc., 627 N.W.2d 396, 400 (S.D. 2001).

11. *E.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 92-94 (4th ed. 1992).

> deal with them might exceed the benefits, when those benefits are discounted by the (low) probability that the contingency will actually occur. It may be cheaper for the court to "draft" the contractual term necessary to deal with the contingency if and when it occurs.[12]

The unresolved question we are left with after accepting this role for the courts in providing implied terms to silent contracts is: How, and in what way, should a court go about determining and inserting terms in a silent contract? The answer, according to Judge Posner, is to "imagine how the parties would have provided for the contingency if they had decided to do so."[13] This entails "decid[ing] what the most efficient way of dealing with the contingency is. For this is the best way of deciding how the parties would have provided for [the contingency]."[14]

Therefore, we have an initial framework that examines the parties' intentions through an efficiency-minded lens; but, what if, after an investigation into the parties' intentions, a court concludes that the parties would have provided for the contingency in an inefficient way? Or, as Posner notes, "If the law is to take its cues from economics, should efficiency or intentions govern?"[15] In this case, the perceived inefficient intentions of the parties should govern because "people who make a transaction—thus putting their money where their mouths are—ordinarily are more trustworthy judges of their self-interest than a judge (or jury), who has neither a personal stake in nor first-hand acquaintance with the venture."[16] Consequently, if there is clear evidence of the probable intentions of the parties where there is no express term covering an unprovided for contingency, a court should defer to the parties' intentions even in the face of the court's conclusion that those intentions are economically inefficient.

Because fiduciaries and their businesses negotiate contracts, employment or otherwise, that define the rights and obligations of each party, an efficiency-minded, gap-filling, or "bargain-substitute" framework seems well suited to interpret

12. *Id.* at 92-93.
13. *Id.* at 93.
14. *Id.*
15. *Id.*
16. POSNER, *supra* note 11, at 93.

these types of contracts as well. Although the commentary is not unanimous,[17] recent scholarship, consistent with Posner's general contract framework, suggests courts should impose corporate opportunity duty of loyalty rules to "fill the gap" in the performance of express or implied fiduciary contracts.[18] Fiduciaries and businesses, like other contracting parties, need courts to "fill the gap" in contracts because the costs associated with contemplating every possible corporate opportunity scenario, and agreeing to mutual performance in each scenario, would be prohibitively high.[19]

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17. In addition to the contractarian view of the duty of loyalty, some "traditionalists [regard] fiduciary duties as the doctrinal cousin to the law of trusts." Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L.J. 277, 299 (1998). Under this approach, a fiduciary's duties are similar to those of a common law trustee. *Id.* Another approach is the "communitarian" approach, which has gained popularity in recent years. *See id.* at 302. Communitarians posit that "allocati[ve] decisions made within a firm can have significant stakes for numerous other constituencies, including employees, creditors, suppliers, customers, and surrounding communities." *Id.* An example of a "communitarian" corporate statute can be found in many states, including Minnesota. *See, e.g.*, MINN. STAT. § 302A.251, subd. 5 (1985). These statutes permit a board of directors, in discharging its duties, and "in considering the best interests of the corporation," to "consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations." *Id.* Application of the communitarian approach in the corporate opportunity context, however, is still relatively indeterminate and therefore is not currently a useful model. *See* Talley, *supra*, at 303.

18. *See, e.g.*, Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987) (suggesting that "[b]ecause fiduciary duty is a standby or off-the-rack guess about what parties would agree to if they dickered about the subject explicitly, parties may contract with greater specificity for other arrangements. It is a violation of duty to steal from the corporate treasury; it is not a violation to write oneself a check that the board has approved as a bonus."); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993); Scott W. Fielding, Note, *Free Competition or Corporate Theft?: The Need for Courts to Consider the Employment Relationship in Preliminary Steps Disputes*, 52 VAND. L. REV. 201, 223-24 (1999) (recognizing a hypothetical-bargain view); Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214, 216-17 (1999).

19. *See* Kenneth B. Davis, Jr., *Corporate Opportunity and Comparative Advantage*, 84 IOWA L. REV. 211, 221 (1999) ("Generally-worded contracts of employment embody all the uncertainty and room for argument that characterize the existing fiduciary-based doctrine. Attempts to deal with these problems through greater specificity raise the challenge of contemplating and providing for endless contingencies in a world of limited knowledge (the so-called 'bounded rationality' problem)."); Andrew J. Nussbaum, *Like Money in the Bank?: An Economic Analysis*

Professor Pat Chew, consistent with the framework above, argues that corporate opportunity

> disputes [should] 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.[20]

Judge Frank Easterbrook and Professor Daniel Fischel also imply, in their general contract-based analysis of fiduciary duty, that enforcement of the duty of loyalty between officers/directors and their businesses "replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced."[21] "The fiduciary relationship, in other words, is rarely an all-or-nothing proposition, and in interpreting the implicit contract that underlies that relationship we need to determine the appropriate balance."[22]

One criticism of the gap-filling or hypothetical contract approach to fiduciary duty (one I partially concede later in the Ar-

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of Fiduciary Duties to Protect the S & L Deposit Insurance Fund, 44 ADMIN. L. REV. 355, 359-62 (1992).

20. Pat K. Chew, *Competing Interests in the Corporate Opportunity Doctrine*, 67 N.C. L. REV. 435, 439 (1989). Professor Chew describes her corporate opportunity model as a "reasonable expectations model." *Id.* at 440.

21. Easterbrook & Fischel, *supra* note 18, at 427; *cf. Jordan*, 815 F.2d at 436-37 (suggesting that the duty of a closely-held corporation to disclose material information when repurchasing its shares from employee insiders may be modified by express contract). Indeed, Easterbrook and Fischel contemplate one defense to a fiduciary's usurpation of a corporate opportunity when they recognize that a "board of directors may authorize a manager to pursue corporate opportunities" notwithstanding the ability of the entity to develop the opportunity. Easterbrook & Fischel, *supra* note 18, at 429; *see also infra* Section C of Part II. For a scathing critique of Easterbrook and Fischel's general approach to corporate law and to contractual theories of the duty of loyalty, see generally Lawrence E. Mitchell, *The Cult of Efficiency*, 71 TEX. L. REV. 217 (1992) (book review).

22. Davis, *supra* note 19, at 229; *see also* Talley, *supra* note 17, at 280-81 ("[F]ashioning a rule that replicates (at least functionally) the allocation [of property rights] that the parties themselves would have bargained for ex ante had they anticipated such contingencies should be an important goal of the courts."). *See generally* Fielding, *supra* note 18, at 226-27 (arguing that the hypothetical bargain view of the duty of loyalty should be used to distinguish between relative duties of loyalty based on employee status).

ticle) is that it also suffers from a degree of indeterminacy and thus may not offer a clearly superior alternative analysis for courts to use when evaluating corporate opportunity claims.[23] This indeterminacy problem arises because "constructing the supposed bargain of business partners after the fact may produce results as variable and random as those yielded by" the traditional approaches to fiduciary duty.[24] An example is the case of *Jordan v. Duff & Phelps, Inc.*[25] Here, Judges Easterbrook and Posner (both strong advocates of the "gap-filling" purpose of fiduciary duty) disagreed as to what the parties would have contracted for in deciding whether Duff and Phelps had breached a fiduciary duty of disclosure to Jordan in failing to notify him that the company was about to be acquired before repurchasing his stock.[26]

Nevertheless, while mindful of the objections made by the traditionalist defenders of fiduciary duties, this Article's proposed statute is based on a hypothetical contract model grounded in a gap-filling theory of fiduciary duty. As developed below, although a hypothetical contract model of corporate opportunity may suffer from some inherent indeterminacy, it is a superior alternative to both strict disclosure theories of the corporate opportunity doctrine, which may prohibitively inhibit allocative efficiency and distort efficient economic innovation, and the fairness tests, which suffer from the lack of any guiding principles.

Moreover, this theoretical framework for evaluating corporate opportunity claims attempts to blunt any possible indeter-

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23. *See* Robert Hillman, *Business Partners as Fiduciaries: Reflections on the Limits of Doctrine*, 22 CARDOZO L. REV. 51, 57 (2000). For a more thorough critique on this point, see generally Scott Fitzgibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 323-24, 333-35 (1999); Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L.J. 287, 326-30 (1996).

24. Hillman, *supra* note 23, at 58; *see also* Larry E. Ribstein, *Efficiency, Regulation and Competition: A Comment on Easterbrook & Fischel's* Economic Structure of Corporate Law, 87 NW. U. L. REV. 254, 259 (1992) (noting that there are threshold questions before accepting a hypothetical bargain theory; namely "whether there is a gap to fill and whether the courts should fill gaps according to this model").

25. 815 F.2d 429 (7th Cir. 1987).

26. *See generally* Hillman, *supra* note 23, at 58. For a more critical analysis of *Jordan*, as well as a thorough examination of the underpinnings of corporate default rules, see generally Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

minacy created by a hypothetical contract approach by providing that, in cases of clear indeterminacy, courts should fill the gaps in fiduciary contracts with the more efficient term or rule. For example, if a court is unclear whether the parties would have contracted for strict disclosure of corporate opportunities in the absence of an express contractual term, the court should find that the parties would not have contracted for strict disclosure because such a rule likely inhibits efficient economic innovation and allocative efficiency. In other words, where indeterminacy exists under the hypothetical contract approach, the court should supply a term or rule that promotes the efficient allocation of corporate opportunities.

3. *A Contractual Theory of the Duty of Loyalty*

Accepting the premise that fiduciary duties, and specifically the duty of loyalty,[27] are merely gap-filling defaults, some commentators have suggested that parties should be permitted to modify or eliminate them by contract.[28] These commentators concur with Easterbrook, Fischel, and Posner's general gap-filling theory of fiduciary duty and argue that a fiduciary and his business may enter into an express contractual relationship for the fiduciary to opt out of his duty of loyalty and liability under the corporate opportunity doctrine.[29]

27. The distinction between other fiduciary duties and the duty of loyalty may be smaller than one expects after critically examining the substantive differences between the duties. For instance, "[w]hat is the difference between working less hard than promised at a given level of compensation (a breach of the duty of care) and being compensated more than promised at a given level of work (a breach of the duty of loyalty)?" FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 103 (1991).

28. *See generally* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 459-64 (1998). For instance, Cohen notes that in the L.L.C. context "states are permitting . . . parties to agree by contract to the meaning of the duty [of loyalty], but are not allowing the elimination of that duty." *Id.* at 462. He recognizes, however, the contradictory nature of such a view of the duty of loyalty: "[Such view] seems contradictory. States trust the contracting process and assume equal bargaining and adequate information, but do not trust the process enough to eliminate the duty of loyalty. This strange combination of trust and lack of trust will lead to more litigation to help determine the limits of contracting parties." *Id.*

29. *See generally* Richard A. Booth, *Fiduciary Duty, Contract, and Waiver in Partnerships and Limited Liability Companies*, 1 J. SMALL & EMERGING BUS. L. 55,

Indeed, a contractual theory of the duty of loyalty also could solve statutorily or judicially created problems when each institution attempts to apply a hypothetical contract approach to create default rules. For example, the freedom to contract out of a strict duty of loyalty would permit parties to contract out of actual or perceived inefficient gap-filling rules that may be created by courts and legislatures attempting to reconstruct a hypothetical contract term or rule *ex post*. Under this view, although a hypothetical contract approach may be a superior alternative to current rules, it still may not produce the desired efficient results in every case. As two commentators have noted:

> It is, therefore, a mistake to identify the hypothetical bargain approach with the contract theory of the corporation. . . . If anything, the defects of the hypothetical bargain approach provide another argument in favor of the contract theory: To the extent that courts and legislators follow this approach in adopting default provisions, it is important to permit the parties to opt out of it in order to escape its defects.[30]

Advocates of contractual theories of the duty of loyalty, however, are presently fighting a war on two fronts against current state law and the traditionalist defenders of fiduciary duty. First, many state business organization statutes (especially those governing corporations) expressly prohibit the modification or complete elimination of the duty of loyalty; also, many

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60 (1997) ("The fact that fiduciary duty can be abused indicates that it may be worthwhile for parties entering into business to negotiate its scope. . . . If the function of fiduciary duty is to supply missing contract terms, then it is difficult to argue that the parties should not be allowed to negotiate about predictable controversies if they think it is worthwhile to do so."); *see also* Chew, *supra* note 20, at 499 ("[A] contract negotiated in anticipation of possible corporat[e] opportunity disputes allows the parties to reflect carefully about what a fair and well-reasoned resolution [to a dispute] would be."); Davis, *supra* note 19, at 229 ("Contract theory would seem to be particularly suited to the corporate opportunity doctrine since its object is the determination of what belongs to the corporation and what belongs to the officer/director. Whatever the optimal rule, from a transaction-cost standpoint, the parties could override it by contract."); Richard A. Epstein, *Contract and Trust in Corporate Law: The Case of Corporate Opportunity*, 21 DEL. J. CORP. L. 5 (1996). *But see, e.g.*, MINN. STAT. § 302A.251, subd. 4 (1985) ("The articles [of incorporation] shall not eliminate or limit the liability of a director . . . for any breach of the director's duty of loyalty to the corporation or its shareholders . . . .").

30. Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 17 (1990).

expressly prohibit the limitation of damages for breaches of the duty of loyalty.[31] Second, advocates of contractual theories of the duty of loyalty have encountered fierce opposition from traditionalist defenders of fiduciary duty who argue that fiduciary duties are something more than mere gap-filling contract rules.[32] For instance, Judge Lawrence Mitchell has argued, "The fiduciary principle underlying the duty of loyalty provides a legal and social infrastructure for the trust a person necessarily evidences when she enters into a relationship with another to manage her property."[33] In addition, according to Judge Mitchell, expectations under a "hypothetical bargain approach . . . necessarily will be formed in a context of inequality and power disparity. To permit [hypothetical bargain] expectations formed in such an environment to govern [fiduciary] relationships is to abrogate the very reason for fiduciary duties in the first place."[34]

Although these criticisms may be persuasive in the context of other fiduciary relationships, for example, trustee/beneficiary, lawyer/client, etc., such worries are likely unfounded in the context of corporate fiduciary contracts.[35] As will be further developed below, a contractual theory of the duty of loyalty contemplates a bargaining atmosphere where the business and the fiduciary have relatively equal bargaining strength. Moreover, any decision to modify or eliminate a fiduciary's duty of loyalty would still be subject to the business judgment rule, as well as market forces that may prompt investors to liquidate their interests in entities that agree to modify or eliminate their standards of fiduciary loyalty. For example, Henry Butler and Larry Ribstein note:

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31. *E.g.*, DEL. CODE ANN. tit. 8 § 102(7) (1974); MINN. STAT. § 302A.251, subd. 4(a) (1985).

32. *E.g.*, Fitzgibbon, *supra* note 23.

33. Mitchell, *supra* note 21, at 233. Scott Fitzgibbon similarly declares that fiduciary duties "facilitate the doing of justice . . . promote virtue, and . . . enhance freedom in a distinctive way." Fitzgibbon, *supra* note 23, at 305.

34. Mitchell, *supra* note 21, at 237 (citation omitted).

35. *E.g.*, Fitzgibbon, *supra* note 23, at 306-08 (grouping corporate fiduciaries into the same category as guardian/ward, bailee/bailor, physician/patient, and priest/penitent fiduciary relationships without recognizing the significant substantive differences between each fiduciary relationship).

> A thorough understanding of the Efficient Capital Markets Hypothesis reveals that securities markets are efficient in the sense that a corporate shareholder gets what he is paying for in both the terms of the contract and the substantive nature of the product, including the quality of management. . . .
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> . . . .
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> The information efficiently reflected in market prices includes the terms of contracts constraining managerial discretion and the prospects that this discretion will be exercised consistently with investor interests. Any change in these contracts, and any change in or new information about the managers of such a corporation, such as their track records, reputations and the like, will be reported in the financial media. Through the mechanisms of market efficiency, this information is reflected in market price. And because information about contract terms and managers is accurately reflected in market price, investors get what they pay for, and capital is allocated to the most efficient firms.[36]

It is this axiomatic understanding of the market, therefore, that would provide a market-based constraint on fiduciary conduct—at least for publicly traded firms. Because the market would necessarily constrain fiduciary conduct, most of the traditionalist arguments against a contractual theory of the duty of loyalty apply with less force.[37]

B. *Establishing the Existence of a Corporate Opportunity*

In this Part, the four primary tests courts use to determine whether an opportunity is a "corporate opportunity" will be examined. In most jurisdictions, courts will initially evaluate whether a corporate opportunity existed by applying the test, or an adaptation thereof, from the seminal Delaware case of *Guth v. Loft.*[38] These "traditional" tests examine whether (1) the claimed opportunity arose out of a preexisting right, interest or expectancy of the business; (2) the opportunity was in the business's line of business; or (3) the opportunity was of practical advantage to the business.[39]

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36. Butler & Ribstein, *supra* note 30, at 33, 35 (citations omitted).

37. *See generally id.* (providing a thorough critique of traditionalist arguments that the market is unable to constrain unfaithful fiduciary conduct).

38. 5 A.2d 503 (Del. 1939).

39. *See id.* at 511. At least one commentator, perhaps correctly, recognizes that the traditional corporate opportunity tests are merely conclusions of law. *Corporate Opportunity in the Close Corporation—A Different Result?*, *supra* note 9,

Since 1939, however, when the Delaware Supreme Court decided *Guth,* courts and commentators have modified (and in some cases explicitly rejected) the *Guth* test to address various factors that they felt were not adequately addressed by the *Guth* court.[40] For example, the Minnesota Supreme Court engages in a two-step inquiry to determine first whether an opportunity was a corporate opportunity, and, second, whether the opportunity was usurped by a fiduciary.[41]

In addition, in some modern cases, courts have embraced the view of Professors Victor Brudney and Robert Clark who have advocated for a strict view of the corporate opportunity doctrine in order to enforce their concomitant strict view of the duty of loyalty.[42] In the same vein, the American Law Institute also has promulgated principles of corporate governance detailing its view of the corporate opportunity doctrine, which mirrors in many ways the strict view advocated by Brudney and Clark.[43]

Because the history and features of each test are essential to understand why each is unsatisfactory, all of these tests are thoroughly examined below. But because the "strict" tests focus on a fiduciary's initial conduct—her conduct before taking an opportunity—these tests give relatively short shrift to the question whether the opportunity should even be categorized as one that properly belongs to the business.

1. *The Traditional Tests*

Modern courts usually apply some variation of the test the Delaware Supreme Court promulgated in *Guth v. Loft.*[44] The

at 382 ("Aside from concealing the true determinants—the underlying fact patterns—these conclusory tests have proved to be indistinguishable and meaningless.").

40. *See* sources cited *infra* notes 56-59 and accompanying text.

41. *See* Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974); *see* discussion *infra* Part II.B.2.

42. *See* Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 998, 1000 (1981); *see* discussion *infra* Part II.B.3.

43. *See* PRINCIPLES OF CORPORATE GOVERNANCE § 5.05 (Am. Law. Inst. 1994) [hereinafter ALI]. *See* discussion *infra* Part II.B.4.

44. 5 A.2d 503 (Del. 1939). For a concise summary of the facts and reasoning of *Guth*, see Chew, *supra* note 20, at 455-59 (describing *Guth*'s "line of business" test); Eric G. Orlinsky, *Corporate Opportunity Doctrine and Interested Director Transactions: A Framework for Analysis in an Attempt to Restore Predictability,* 24

Guth court concluded that a plaintiff[45] might establish a corporate opportunity if it showed several factors to be present:

> [I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of . . . business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.[46]

The *Guth* court's formulation merged earlier corporate opportunity tests—the preexisting right and interest or expectancy tests[47] that focused on opportunities arising out of preexisting corporate economic relationships—with a line of

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DEL. J. CORP. L. 451, 466-73 (1999); David J. Brown, Note, *When Opportunity Knocks: An Analysis of the Brudney and Clark and ALI Principles of Corporate Governance Proposals for Deciding Corporate Opportunity Claims*, 11 J. CORP. L. 255, 256-57 (1986).

45. In most cases, the burden is on the plaintiff to establish a fiduciary relationship and the existence of a corporate opportunity before the fiduciary is permitted to defend his conduct. *See* Ostrowski v. Avery, 703 A.2d 117, 121 (Conn. 1997). If the plaintiff fails to establish the existence of a corporate opportunity, the judicial inquiry ends and the fiduciary is not liable for taking the opportunity. *See id.* The proposed statute follows this well-recognized practice, but increases the burden on the fiduciary to establish his applicable defenses by clear and convincing evidence. *See id.*; *see also infra* Part III.

46. *Guth*, 5 A.2d at 511.

47. *See* Miller v. Miller, 222 N.W.2d 71, 79-80 (Minn. 1974) (characterizing the interest or expectancy test as "preclud[ing] acquisition by corporate officers . . . of a business opportunity in which the corporation has a 'beachhead' in the sense of a legal or equitable interest or expectancy growing out of a preexisting right or relationship"); *see also* United Seal & Rubber v. Bunting, 285 S.E.2d 721, 722 (Ga. 1982); Pioneer Oil & Gas Co. v. Anderson, 151 So. 161, 163 (Miss. 1933). In *Lagarde v. Anniston Lime & Stone Co.*, 28 So. 199, 201 (Ala. 1900), the Alabama Supreme Court clearly articulated the preexisting right/interest or expectancy test: "[I]n general the legal restrictions which rest upon such officers in their acquisitions are generally limited to property wherein the corporation *has an interest already existing*, or in which it has an *expectancy growing out of an existing right* . . . ." *Id.* (emphasis added). For a summary of the facts in *Lagarde*, see Chew, *supra* note 20, at 459-60. The Alabama Supreme Court has subsequently interpreted the language in *Lagarde* to be the equivalent of the broader *Guth* test. *See, e.g.*, Morad v. Coupounas, 361 So. 2d 6, 9 (Ala. 1978). Similarly, in *Carper v. Frost Oil Co.*, 211 P. 370 (Colo. 1922), the court cited then existing authority that suggested that whether a corporate opportunity is established "depends upon whether the corporation has an interest, actual or in expectancy," in the corporate opportunity. *Id.* at 371. *See generally* Brown, *supra* note 44, at 262-63; Talley, *supra* note 17, at 292-93.

business/practical advantage inquiry.[48] The line of business inquiry is perhaps *Guth*'s broadest inquiry.[49] An opportunity is in a line of business if the opportunity is "so closely associated with the existing business activities . . . as to bring the transaction within that class of cases where the acquisition of the [opportunity] would throw the corporate officer . . . into competition with his company."[50] The *Guth* court expanded on this concept later in its opinion stating:

> Where a corporation is engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business . . . and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business.[51]

Other courts have nuanced the all-encompassing *Guth* test by examining whether the opportunity was (1) within the "avowed business purpose" of the business;[52] (2) "reasonably incident to its present or prospective operations";[53] or (3) "so

48. *See generally* Orlinsky, *supra* note 44.

49. *See Guth*, 5 A.2d at 514 ("The phrase [line of business] is not within the field of precise definition, nor is it one that can be bounded by a set formula. It has a flexible meaning, which is to be applied reasonably and sensibly to the facts and circumstances of the particular case."); *Miller*, 222 N.W.2d at 80 (recognizing that the line of business test established in *Guth* is "more flexible in scope than the restrictive 'interest or expectancy' test of earlier decisions").

50. *Guth*, 5 A.2d at 513; *see also* Note, *Corporate Opportunity*, *supra* note 9, at 769 ("The line of business apparently does not stop at the boundary of the corporation's current operations, but seems also to embrace areas into which the corporation might naturally or easily expand."). *See generally* Talley, *supra* note 17, at 289-92; James L. Rigelhaupt, Jr., 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).

51. *Guth*, 5 A.2d at 514.

52. *Ostrowski*, 703 A.2d 117, 122 (Conn. 1997). The *Ostrowski* court stated that "[t]he avowed business purpose test . . . is a variant of the 'line of business' test." *Id.* at 123. The "test asks whether the opportunity is 'closely associated with the existing and prospective activities of the corporation . . . .'" *Id.* (quoting Rosenblum v. Judson Eng'g Corp., 109 A.2d 558 (N.H. 1954)); *see also* Giulietti v. Giulietti, 784 A.2d 905, 948 (Conn. App. Ct. 2001) ("Pursuant to the avowed business purpose test, the potential opportunity need not be identical to the corporation's current activities. Only a 'close relationship' is required.").

53. Kerrigan v. Unity Sav. Ass'n, 317 N.E.2d 39, 43 (Ill. 1974); *see also* Brown, *supra* note 44, at 258 ("A corporation's special competency in an area can be expected to extend beyond merely the existing operations. Corporations are dy-

closely associated with the existing and prospective activities of the corporation that the defendants should fairly have acquired that business for or made it available to the corporation."[54] In addition, concepts of good or bad faith are usually not evaluated in making an initial determination whether an opportunity was corporate in nature.[55]

Courts and commentators have long criticized the *Guth* test, especially its line of business inquiry, for its conceptual ambiguity and potentially illogical results.[56] For instance, an opportunity to purchase adjacent land may not be in the line of business, or have anything to do with operating a golf course, but it may still be "detrimental to the best interests of the [c]lub"[57] if the course plans to expand in the future.[58] Other courts have acknowledged the opposite result: the line of business inquiry will conclusively establish a corporate opportunity where one should not be found due to the relationship of the parties involved.[59]

Notwithstanding this judicial and academic criticism, the *Guth* test is the most widely accepted test for establishing whether an opportunity is a corporate opportunity under the corporate opportunity doctrine, and, therefore, it anchors the proposed statute's initial inquiry later in this Article.[60]

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namic, evolving entities. To limit the definition of 'line of business' to a corporation's existing [activities] is to deny this fact.").

54. *Rosenblum*, 109 A.2d at 563.

55. *See, e.g.*, *id.* (stating that "bad faith is [not] essential to the establishment of a duty on the officers and directors of a corporation in connection with business opportunities which they have acquired for themselves"); Production Machine Co. v. Howe, 99 N.E.2d 32, 36 (Mass. 1951) ("Breach of duty [can] be found although no corruption, dishonesty, or bad faith was involved."); Miller v. Miller, 222 N.W.2d 71, 82 (Minn. 1974).

56. *See* Chew, *supra* note 20, at 466 ("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.").

57. Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1149 (Me. 1995).

58. For a detailed discussion of *Northeast Harbor Golf Club*, see generally Harvey Gelb, *The Corporate Opportunity Doctrine—Recent Cases and the Elusive Goal of Clarity*, 31 U. RICH. L. REV. 371, 374-82 (1997).

59. *See* Burg v. Horn, 380 F.2d 897, 900 (2d Cir. 1967).

60. *See infra* Part III.

2. *The* Miller *"Two-Step"*

The Minnesota Supreme Court in *Miller v. Miller*[61] approached the challenge of corporate opportunity by establishing a two-step inquiry.[62] The *Miller* court's first inquiry determines whether a business opportunity is a corporate opportunity, and it is essentially a flexible application of *Guth*'s line of business inquiry.[63] According to the *Miller* court, several factors should be examined:

> Whether the business opportunity presented is one in which the complaining corporation has an interest or an expectancy growing out of an existing contractual right; the relationship of the opportunity to the corporation's business purposes and current activities—whether essential, necessary, or merely desirable to its reasonable needs and aspirations—; whether, within or without its corporate powers, the opportunity embraces areas adaptable to its business and into which the corporation might easily, naturally, or logically expand; the competitive nature of the opportunity . . . and whether the opportunity includes activities as to which the corporation has fundamental knowledge, practical experience, facilities, equipment, personnel, and the ability to pursue.[64]

Therefore, "[i]f the facts are undisputed that the business opportunity presented bears no logical or reasonable relation to the existing or prospective business activities of the corporation . . . then such opportunity would have to be found to be noncorporate as a matter of law."[65] The *Miller* court's second step examines the inherent fairness of the fiduciary's conduct and will be examined below when fiduciary defenses are discussed.[66]

61. 222 N.W.2d 71 (Minn. 1974). For background on *Miller*, see Chew, *supra* note 20, at 462-63.

62. *See generally* Orlinsky, *supra* note 44, at 458-59.

63. *See Miller*, 222 N.W.2d at 81.

64. *Id.* The ellipsis in the block quote omits language regarding the financial ability of the business to exploit the opportunity. *Id.* This "factor" will be discussed during the evaluation of fiduciary defenses. *See infra* Section C of Part II.

65. *Miller*, 222 N.W.2d at 81.

66. *See infra* Section C of Part II.

3. *The Brudney and Clark Approach*

Victor Brudney and Robert Clark essentially retain the *Guth* test to establish whether an opportunity should be treated as sufficiently "corporate," although they argue that public and close corporations should be treated differently when evaluating corporate opportunity claims.[67] They further distinguish between full-time executives and outside directors/part-time executives in adopting their rules for evaluating corporate opportunity claims.[68]

In the close corporation context:

> (1) If the disputed opportunity is functionally related to the corporation's business, then, whether or not it is "necessary" or of "special value," individual participants may not take it.
> (2) If the corporation has an "interest" or "expectancy" in the opportunity, individual participants may not take it.[69]

Conceding that the "functionally related" test "will not offer bright lines by which to decide particular cases,"[70] they argue that the concept "assumes that the manufacturing or sales processes of the new project, or perhaps its resources, overlap with the enterprise's existing business operations to produce nontrivial synergistic gains" which could come from "complementary values . . . parallel opportunities . . . or the exploitation of additional sources of natural resources or quantities of the same product."[71] Believing that this admittedly broad test will not sufficiently deter fiduciaries from taking opportunities, they place the burden of proving that the opportunity was *not* func-

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67. *See* Brudney & Clark, *supra* note 42, at 1000. In doing so, Brudney and Clark use a selective approach for close corporations and a categorical approach for public corporations. As later parts of this Article demonstrate, the distinction is unnecessary because most corporate opportunity claims arise in the closely held business context. Moreover, the likelihood that a full-time executive of a public corporation would usurp a corporate opportunity from his corporation is likely rather small. *See infra* Section A of Part IV. For a concise description of the Brudney and Clark approach, see Brown, *supra* note 44, at 265-66.

68. *See* Brudney & Clark, *supra* note 42, at 1000.

69. *See id.* at 1011; *see also* Klinicki v. Lundgren, 695 P.2d 906, 916 (Or. 1985) (referring to the close corporation test).

70. Brudney & Clark, *supra* note 42, at 1012.

71. *Id.* (footnotes omitted).

tionally related to the business on the fiduciary, absent receipt of consent before the taking.[72]

Describing their second inquiry, Brudney and Clark opine that "[t]he concept of an interest or expectancy . . . is fundamentally an extension of the concept of corporate property."[73] They then back off from this characterization, asserting that "an interest or expectancy is not legally 'property,' even though it may be economically capitalizable and of sufficient value to be salable in arm's-length transactions."[74] Unable to decide on a satisfactory definition for their articulation of "interest or expectancy," Brudney and Clark throw up their hands and concede that "[t]he intrinsic ambiguity of the concept suggests, as in the case of determining whether opportunities are functionally related, that the burden be placed on the challenged fiduciary to prove the absence of an interest or expectancy."[75]

With respect to full-time executives in public corporations, they adopt a categorical rule prohibiting the "taking [of] any other active business opportunity"[76] and reason that such a rule "would result in considerable social benefit at little, if any, social cost."[77] Their definition of a corporate opportunity for a public corporation is as broad as theoretically possible and "include[s] all possibilities of acquiring profitable businesses with a rate of return and risk level no worse than that of its other operations."[78]

In sum, the Brudney and Clark approach for corporate opportunity mirrors, in many ways, the broad *Guth* inquiry; but it presumptively places the burden of proving that the opportu-

72. *Id.* at 1013 ("Thus, unless the participant who takes an opportunity has received such consent, either in advance or contemporaneously, the new project should be presumed to be functionally related to the business of the corporation and the diverter should have the burden of proving the contrary.").

73. *Id.* (footnote omitted).

74. *Id.* at 1014. As Professor Kenneth Davis correctly recognizes, this is exactly why the corporate opportunity doctrine exists: "If the party already had a legally protected property interest, resort to the equitable strictures of the corporate opportunity doctrine would be unnecessary. Rather, the function of the corporate opportunity doctrine is to apply property-like protection where no conventional property right exists." Davis, *supra* note 19, at 236.

75. Brudney & Clark, *supra* note 42, at 1016.

76. *Id.* at 1023.

77. *Id.* at 1024.

78. *Id.* at 1025.

nity was not corporate on the fiduciary, absent consent, in a close corporation. It also categorically prohibits full-time executives of public corporations from taking any profitable opportunities they encounter during their employment.

4. *The American Law Institute Approach*

The American Law Institute ("ALI") approach to corporate opportunity, promulgated in 1994,[79] also borrows substantially from the *Guth* test.[80] The principal feature of the ALI test is its strict requirement that the fiduciary disclose a potential corporate opportunity to his business.[81] Under the ALI test's general rule, "[a] director or senior executive may not take advantage of a corporate opportunity unless: (1) The director or senior executive first offers the corporate opportunity to the corporation and makes disclosure concerning the conflict of interest and the corporate opportunity; [and] (2) The corporate opportunity is rejected by the corporation . . . ."[82] Further, the rejection must satisfy several conditions:

> (A) The rejection of the opportunity [must be] fair to the corporation;
>
> (B) The opportunity [must be] rejected in advance, following such disclosure, by disinterested directors, or, in the case of a senior executive who is not a director, by a disinterested superior, in a manner that satisfies the standards of the business judgment rule; or
>
> (C) The rejection [must be] authorized in advance or ratified, following such disclosure, by disinterested shareholders, and the rejection [must not be] equivalent to a waste of corporate assets.[83]

Under the ALI test, the party challenging the taking of an opportunity has the initial burden of proving the existence of the corporate opportunity.[84] A corporate opportunity is an op-

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79. ALI, *supra* note 43, § 5.05.

80. For a description and critique of the ALI test, see Brown, *supra* note 44, at 267-68. *See generally* THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 305-08 (Dennis J. Block et al. eds., 1998) (discussing the ALI test).

81. ALI, *supra* note 43, § 5.05(a)(1).

82. *Id.* § 5.05(a)(1)-(2).

83. *Id.* § 5.05(a)(3).

84. *Id.* § 5.05(c).

portunity that a director or senior executive encounters "[i]n connection with the performance of functions as a director or senior executive, or under circumstances that should reasonably lead the director or senior executive to believe that the person offering the opportunity expects it to be offered to the corporation . . . ."[85] Furthermore, a corporate opportunity also can be established if "[t]hrough the use of corporate information or property, . . . the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation; or . . . is closely related to a business in which the corporation is engaged or expects to engage."[86]

On its face, the ALI test adds nothing to the traditional tests (other than its strict disclosure requirement) although the clause "reasonably be expected to believe would be of interest to the corporation" seems to encompass any potentially profitable business opportunity.[87] Indeed, the comments to the ALI recommendation contemplate this observation.[88] Overall, ALI sought to establish "a more flexible standard for application to particular cases, because it does not limit the doctrine's applicability to a particular 'line of business,' and applies the doctrine to a contemplated activity in which the corporation may subsequently engage."[89] Although the ALI test does not explicitly reference the interest or expectancy test, the comments make clear that ALI also sought to incorporate that test in its recommendation.[90]

C. *Fiduciary Defenses to Corporate Opportunity Claims*

Although a fiduciary may assert several defenses in response to corporate opportunity claims, five primary defenses have been recognized and, in some jurisdictions, explicitly rejected. Fiduciaries may claim that they should be absolved from liability under the corporate opportunity doctrine because

85. *Id.* § 5.05(b)(1)(A).

86. ALI, *supra* note 43, § 5.05(b)(1)(B)-(2).

87. *Id.* § 5.05(b)(1)(B).

88. *Id.* § 5.05(b) cmt. b(2) ("Section 5.05(b)(2) expands the scope of corporate opportunity beyond the concept of an existing 'line of business,' . . . to cover an existing or contemplated activity of the corporation . . . .").

89. *Id.*

90. *Id.*

(1) the business consented to a taking, either in individual cases, or categorically through *ex ante* blanket consent;[91] (2) the taking of the opportunity was fair to the business;[92] (3) the business was legally unable to exploit the opportunity when it was presented, or a third party refused to deal with the fiduciary's business;[93] (4) the business was financially unable to exploit the opportunity when it was presented to the fiduciary;[94] or (5) the opportunity was presented to the fiduciary in his individual, as opposed to his official/corporate capacity.[95]

1. *Individual and Blanket Consent by the Business*

Every corporate opportunity test, except perhaps the Brudney and Clark approach, permits a business to consent individually to a fiduciary's taking of an opportunity. Most tests, however, require that consent be given by disinterested decisionmakers—either the board of directors (or similar body) or the shareholders—for the consent to be effective.[96]

Although the *Guth* court did not mention consent as a possible fiduciary defense, courts applying the reasoning of *Guth* have consistently recognized that *ex ante* consent absolves a fiduciary from liability under the corporate opportunity doctrine.[97] Courts, however, have consistently held that consent must be given by a disinterested group of decisionmakers, much like the similar requirement in the area of corporate self-dealing.[98] Therefore, "'[i]f the opportunity is rejected by the corporation, at least by a disinterested vote of the board of directors

91. *See infra* note 96–118 and accompanying text.

92. *See infra* note 119–33 and accompanying text.

93. *See infra* notes 134–42 and accompanying text.

94. *See infra* notes 143–64 and accompanying text.

95. *See infra* note 165–70 and accompanying text.

96. *See supra* Section B of Part II.

97. *See, e.g.,* Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 157 (Del. 1996) (stating that "presenting the opportunity to the board creates a kind of 'safe harbor' for the director, which removes the specter of a *post hoc* judicial determination that the director or officer has improperly usurped a corporate opportunity"); Schildberg Rock Products Co. v. Brooks, 140 N.W.2d 132, 138 (Iowa 1966) ("Where a corporation . . . declines [an opportunity] an officer or director may embrace [that opportunity] as his own without accounting to the corporation.") Chem. Dynamics, Inc. v. Newfeld, 728 S.W.2d 590, 593 (Mo. Ct. App. 1987) (noting that a fiduciary may take a corporate opportunity if "that opportunity is first offered to the corporation").

98. *See, e.g.,* Ostrowski v. Avery, 703 A.2d 117, 125 (Conn. 1997).

after full disclosure, the opportunity usually ceases to be a corporate opportunity.'"[99] Other courts have added the requirement that the consent not be "'detrimental to the creditors of the corporation.'"[100] Finally, effective consent may be implied from the circumstances if an opportunity is presented to a business and not taken advantage of over a period of time,[101] although this also could be characterized as *ex post* ratification.[102]

The *Miller* court, in its two-step approach to corporate opportunity claims, also recognized a consent defense. As part of its fairness inquiry, the court stated that one significant factor a court should consider is "prior disclosure of the opportunity to the board of directors or shareholders and their response."[103] The *Miller* court did not, however, elaborate on why consent absolves a fiduciary from liability under the doctrine.

Contrary to both the traditional tests and the *Miller* two-step approach, Brudney and Clark diverge and plainly permit a consent defense in the close corporation context; whereas they categorically eliminate the defense in the case of public corporations. According to Brudney and Clark, in the close corporation context "only express contemporaneous consent should permit a diversion that would otherwise be unlawful."[104] Absent express, contemporaneous consent, "the burden should be on the diverter to prove for other opportunities that the particular diversion was originally consented to by the founding venturers."[105]

99. *Id.* (citation omitted); *see also* Note, *Corporate Opportunity*, *supra* note 9, at 773.

100. *See, e.g.*, CST, Inc. v. Mark, 520 A.2d 469, 471 (Pa. 1987) (recognizing that a fiduciary may take an opportunity "'if the same is made known to the shareholders, who consent to the acquisition of the opportunity by the individual officer or director instead of the corporation, and such action is not detrimental to the creditors of the corporation'" (quoting Hill v. Hill, 420 A.2d 1078, 1082 (Pa. Super. Ct. 1980))).

101. *See* Md. Metals, Inc. v. Metzner, 382 A.2d 564, 573 (Md. 1978) (concluding that the business's "procrastination and intransigence amounted to no less than an abandonment of whatever corporate opportunity might have existed").

102. *See, e.g.*, Canion v. Tex. Cycle Supply, Inc., 537 S.W.2d 510, 514 (Tex. Civ. App. 1976) (noting that "where the actions or transactions of directors of a corporation are involved, and the claim is made that the directors are personally interested, such action or transaction may be ratified by a vote or acquiescence of all, or a majority, of the stockholders").

103. Miller v. Miller, 222 N.W.2d 71, 82 (Minn. 1974).

104. Brudney & Clark, *supra* note 42, at 1019.

105. *Id.*

But they do not offer any guide to assist a fiduciary to demonstrate implied consent.

In the public corporation context, they begin by asserting that "consent to [an] officer's taking [of] a corporate opportunity approaches the kind of waste for which unanimous stockholder approval is traditionally required"[106] and "the adequacy of any feasible procedure to effect such consent [is doubtful]."[107] Even if the decisionmakers are formally disinterested, according to Brudney and Clark, consent will not be "adequately informed and impartial" because "[t]he consent of fellow officers may well suffer from lack of objectivity; the consent of stockholders, from lack of knowledge; and the consent of outside directors, from lack of proper incentives."[108] Because of these significant problems with *ex ante* consent, Brudney and Clark conclude that "[t]he absence of any compelling reasons to permit 'proper' diversions emphasizes the pointlessness of incurring such a cost."[109]

Nevertheless, Brudney and Clark recognize that a jurisdiction may wish to recognize a consent defense. In this situation, they argue "the test of such consent should be realistic."[110] The corporation must give

> notice of each opportunity [to the shareholders], stating explicitly its estimated value or potential and why the corporation has decided to reject it and permit the officers to take it. And approval by stockholders or disinterested directors should not preclude de novo judicial assessment of the transaction, at least in measuring the appropriating executive's responsibility; the "business judgment" defense should not be permitted to shield the arrangement from meaningful judicial scrutiny.[111]

The ALI test also provides for a consent defense, in line with the traditional tests and *Miller* two-step approach.[112] Section 5.05(a) provides that a fiduciary may take a corporate opportunity if he first discloses the opportunity and either "[t]he opportunity is rejected in advance, following such disclosure, by

106. *Id.* at 1033.
107. *Id.* at 1034.
108. *Id.* at 1034 (footnotes omitted).
109. Brudney & Clark, *supra* note 42, at 1035.
110. *Id.*
111. *Id.* at 1035-36 (footnote omitted).
112. *See, e.g.*, Brown, *supra* note 44, at 268-70.

disinterested directors, or, in the case of a senior executive who is not a director, by a disinterested superior, in a manner that satisfies the standards of the business judgment rule . . . ."[113] A business also may properly reject an opportunity if "[t]he rejection is authorized in advance or ratified, following such disclosure, by disinterested shareholders, and the rejection is not equivalent to a waste of corporate assets."[114] The comment to section 5.05(a) also makes clear that a "[f]ailure [of a corporation] to accept the opportunity within a reasonable time will be considered tantamount to a rejection."[115] Therefore, the ALI test accepts the "failure to reject as implied consent" defense, which has been adopted by some of the traditional test courts.

The propriety of permitting a business to give "blanket consent" to the taking of a range of corporate opportunities in its articles of incorporation, or similar instrument, is less accepted as a defense to corporate opportunity claims. There has been, however, a trend towards recognizing this defense. In 2000, the Delaware State Legislature adopted Senate Bill No. 363.[116] Section three of the bill amended section 122, title eight of the Delaware Code by adding a subsection seventeen. Subsection seventeen now permits a corporation to

> [r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or one or more of its officers, directors or stockholders.[117]

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113. ALI, *supra* note 43, § 5.05(a)(3)(B).

114. *Id.* § 5.05(a)(3)(C).

115. *Id.* § 5.05(a) cmt.

116. Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law, ch. 343, § 3, 72 Del. Laws 619 (2000). The session law can be found in Westlaw at DE LEGIS 343 (2000).

117. *Id.* ch. 343, § 3. The synopsis of the senate bill noted that the amendment

> is intended to eliminate uncertainty regarding the power of a corporation to renounce corporate opportunities in advance . . . . It permits the corporation to determine in advance whether a specified business opportunity or class or category of business opportunities is a corporate opportunity of the corporation rather than to address such opportunities as they arise. The subsection does not change the level of judicial scrutiny that will apply to the renunciation of an interest or expectancy of the corporation in a business opportu-

The practical effect of this new subsection likely means that a Delaware corporation may expressly designate *ex ante* what corporate opportunities it is not interested in exploiting. This provision, therefore, may result in more predictability for fiduciaries, who are contemplating taking a business opportunity, when they feel that the opportunity might properly belong to their corporation.[118]

2. *Fairness*

Although the concept of fairness is intertwined with any corporate opportunity analysis, many courts merge their corporate opportunity approach into one solitary question: whether the fiduciary's conduct was fair to the business.[119] Predictably, consistent application of the fairness test/defense has never been achieved.[120]

> nity, which will be determined based on the common law of fiduciary duty, including the duty of loyalty.

S.B. 363, 140th Gen. Assem., Reg. Sess. (Del. 2000). The statute was amended apparently in response to the uncertainties created by the Delaware Court of Chancery in *Siegman v. Tri-Star Pictures, Inc.*, 15 DEL. J. CORP. L. 218 (1989). In *Siegman*, the court denied defendant's motion to dismiss plaintiff's claim that an amendment to Tri-Star's certificate of incorporation, required as part of a potential combination with Coca-Cola, unlawfully eliminated or limited the duty of loyalty for Tri-Star's directors who also were going to be directors of Coca-Cola or Time (another constituent organization to the combination) as a result of the combination. *See generally id.* The Delaware statute at the time, DEL. CODE ANN. tit. 8 § 102(b)(7) (1971), provided that the duty of loyalty could not be eliminated or limited in articles of incorporation. *Id.* at 235. Because the court determined that the proposed amendment to Tri-Star's articles of incorporation, which provided the circumstances where corporate opportunities would be allocated to Tri-Star, or, in the alternative, to Coca-Cola and Time, may have violated the statute's clear prohibitions, the court denied defendant's motion to dismiss. *See id.* at 235-36.

118. *See* Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1270 n.66 (2001) (stating that the "amendment will enable corporations to better avoid corporate-opportunity claims against their directors and officers, as exposure to such claims has been a concern among directors of firms in the high-technology sector").

119. *See, e.g.,* Haseotes v. Cumberland Farms, Inc., 257 B.R. 691, 694-95 (D. Mass 2001); Orlinsky, *supra* note 44, at 460-61. Orlinsky notes that "fairness only plays a small role in determining whether a corporate opportunity exists in the first place." Orlinsky, *supra* note 44, at 463. *See generally* Annotation, *Fairness to Corporation Where "Corporate Opportunity" is Allegedly Usurped by Officer or Director*, 17 A.L.R.4th 479 (1982).

120. *See* Talley, *supra* note 17, at 293-95.

A classic statement of the fairness test/defense was articulated in *Durfee v. Durfee*.[121] The court concluded:

> that the true basis of the [corporate opportunity] 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 call [sic] for protection. This calls for the application of ethical standards of what is fair and equitable . . . .[122]

Therefore, "[t]he linchpin of the rule and the exceptions is fairness and reasonableness to the corporation. . . . [Consequently], the burden is on the interested parties to demonstrate the fairness and reasonableness of the transaction. That determination is largely a question of fact to be determined from the objective facts and surrounding circumstances existing at the time the opportunity arises."[123]

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121. 80 N.E.2d 522 (Mass. 1948). For a general discussion of the fairness defense and *Durfee*, see Chew, *supra* note 20, at 461-62.

122. *Durfee*, 80 N.E.2d at 529 (quotation marks and citation omitted) (second alteration in original). *Accord* Paulman v. Kritzer, 219 N.E.2d 541, 546-47 (Ill. App. Ct. 1966). It is unclear whether the Massachusetts Supreme Judicial Court has abandoned the fairness test/defense in favor of strict disclosure. *See* Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 183 (Mass. 1997) (stating that "nondisclosure of a corporate opportunity is, in itself, unfair to a corporation and a breach of fiduciary duty"); *id.* at 182 (stating that "to meet a fiduciary's duty of loyalty, a director or officer who wishes to take advantage of a corporate opportunity . . . must first disclose material details of the venture to the corporation"). *See generally In re* Cumberland Farms, Inc., 284 F.3d 216, 227 (1st Cir. 2002) (discussing and applying *Demoulas*). Indeed, at least the First Circuit has recognized that Massachusetts may now be a strict-disclosure state. *Id.* at 229-31.

123. Indep. Distributors, Inc. v. Katz, 637 A.2d 886, 894 (Md. Ct. Spec. App. 1994) (quotation marks and citation omitted); *see also* Weiss v. Kay Jewelry Stores, Inc., 470 F.2d 1259, 1270 (D.C. Cir. 1972) (applying Delaware law); Boyd v. Howard, 556 S.E.2d 337, 339 (N.C. Ct. App. 2001) (six factor test to determine whether a corporate opportunity has been usurped). *Accord* Burg v. Horn, 380 F.2d 897, 900-01 (2d Cir. 1967). The *Burg* court concluded that the proper inquiry was whether "'in any particular case, . . . [there are] circumstances that would make it unfair for [the fiduciary] to take the opportunity for himself.'" *Id.* (quoting Johnston v. Greene, 121 A.2d 919, 924 (Del. Ch. 1956)). The Maryland Court of Special Appeals recently acknowledged that the quoted language in the text from *Katz* resulted in confusion over what constituted the test for corporate opportunity claims in Maryland. *See* Shapiro v. Greenfield, 764 A.2d 270, 278 (Md. Ct. Spec. App. 2000). The *Shapiro* court, however, failed to reconsider the test after discussing its inherent shortcomings. *Id.*

The *Miller* court's second step is a clear and well-articulated example of the fairness test/defense.[124] The *Miller* court concluded that if

> the opportunity is found to be a corporate one, liability should not be imposed upon the acquiring officer if the evidence establishes that his acquisition did not violate his fiduciary duties of loyalty, good faith, and fair dealing toward the corporation. Thus, . . . the ultimate question of liability involves close scrutiny of the equitable considerations existing prior to, at the time of, and following the officer's acquisition.[125]

The court then outlined some examples of relevant considerations applicable to such an inquiry:

> Significant factors which should be considered are the nature of the officer's relationship to the management and control of the corporation; whether the opportunity was presented to him in his official or individual capacity; his prior disclosure of the opportunity to the board of directors or shareholders and their response; whether or not he used or exploited corporate facilities, assets, or personnel in acquiring the opportunity; whether his acquisition harmed . . . the corporation; *and all other facts and circumstances bearing on the officer's good faith and whether he exercised the diligence, devotion, care, and fairness toward the corporation which ordinarily prudent men would exercise under similar circumstances in like positions.*[126]

Therefore, "[t]he *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."[127] Moreover, the last clause, emphasized above, seems to permit a Minnesota court to examine any evidence of fiduciary conduct to arrive at its legal conclusion. It is this hopelessly open-ended inquiry that is rejected later in this Article.[128]

Brudney and Clark reject the fairness defense and argue that the "concept [has] no principled content and seems designed to leave the courts with boundless discretion"; conse-

124. *See generally* Brown, *supra* note 44, at 259-60.

125. Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974); *see also* Southeast Consultants v. McCrary Eng'g Corp., 273 S.E.2d 112, 117 (Ga. 1980).

126. *Miller,* 222 N.W.2d at 81-82 (emphasis added).

127. Chew, *supra* note 20, at 463.

128. *See infra* Section D of Part IV.

quently, the defense "generates much uncertainty about the operational meaning of the legal rule, but no offsetting benefits."[129] The ALI test, however, retains a somewhat confusing application of the fairness test/defense; it permits the defense when a corporate opportunity is presented to the corporation, after full disclosure, and is rejected by the corporation by *interested* directors or shareholders.[130] To put it another way, it permits a fairness defense where there is a "defective" rejection.[131] Although the ALI fairness inquiry seems to be open-ended, one court has suggested that an ALI fairness inquiry "includes consideration of whether the corporation was financially or otherwise incapacitated from undertaking the corporate opportunity."[132]

In sum, although the fairness defense is still recognized in several jurisdictions, its underlying rationale and usefulness is questionable in light of its propensity to create uncertainty for fiduciaries and courts alike.[133]

3. *Legal Inability, Technical Inability & Third Party Refusals to Deal*

The legal inability defense is easy to understand; but, as with the financial inability defense discussed below, is not uniformly recognized by courts. This defense is commonly asserted where a fiduciary believed that her business was precluded from taking an opportunity by restrictions in its corporate char-

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129. Brudney & Clark, *supra* note 42, at 1020.

130. *See* ALI, *supra* note 43, § 5.05(a)(3)(A); *see also* Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1151-52 (Me. 1995).

> If the Club shows that the board did not reject the opportunity by a vote of the disinterested directors after full disclosure, then Harris may defend her actions on the basis that the taking of the opportunity was fair to the corporation. If Harris failed to offer the opportunity at all, however, then she may not defend on the basis that the failure to offer the opportunity was fair.

Harris, 661 A.2d at 1151-52 (citation omitted).

131. The comment to § 5.05 mentions, but does not elaborate on, why ALI decided to retain a fairness defense. According to the comment, if there is *no* disinterested rejection of the corporate opportunity under § 5.05(a)(3)(B)-(C), "the burden of proving fairness [is placed] on the director or senior executive." ALI, *supra* note 43, § 5.05 cmt. a.

132. Klinicki v. Lundgren, 695 P.2d 906, 919 (Or. 1985).

133. *See, e.g.*, Brown, *supra* note 44, at 259 ("The amorphous nature of the fairness test results in uncertainty in application and unpredictability of result.").

ter or by operation of law.[134] Some courts have rejected the legal inability defense on the theory that the business should be notified of the opportunity and be afforded the right to reject the opportunity even if it is initially unable to legally exploit it.[135] In addition to the legal inability defense, at least one court has recognized a technical inability defense where it found that the practical ability of the corporation to take the opportunity was foreclosed by its "critical space problem."[136]

Other courts have recognized that liability under the corporate opportunity doctrine should not be found if the fiduciary shows that a third party who offered the opportunity to the fiduciary initially refused to deal with the business. In *New v. New*,[137] the Los Angeles Board of Supervisors approached a fiduciary of an oil company and "told him in no uncertain terms that a lease would not be given" to the fiduciary's company "and that if [the fiduciary] wanted it [he] would have to take it in person or through another corporation."[138] The court determined that although the corporation had the initial ability to block the project, "the power to negate the enjoyment of a business opportunity . . . does not constitute the kind of an expectancy which lies at the basis of the corporate opportunity doctrine."[139]

Other courts have concluded that although a third party refusal to deal defense is commonly asserted, it should not be rec-

134. *See* Chew, *supra* note 20, at 471-72; Brown, *supra* note 44, at 264.

135. *See, e.g.,* Kerrigan v. Unity Sav. Ass'n, 317 N.E.2d 39, 44 (Ill. 1974).

136. Robinson v. Brier, 194 A.2d 204, 206 (Pa. 1963); *see also* Chew, *supra* note 20, at 473-74 (describing the business-practicality defense). Professor Chew describes an analogous "business-practicality" defense when describing a "Corporate Capability Model." Chew, *supra* note 20, at 473-74. Within this model, the defenses of legal inability, financial inability, business practicality, and third party refusals to deal are recognized. Discussing "business practicality," she notes that such a 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." *Id.* at 474. She concedes, however, that "[t]he courts nevertheless generally have rejected this analysis, presumably because of traditional judicial hesitation to speculate on management decisions and corporate strategy." *Id.*

137. 306 P.2d 987 (Cal. Dist. Ct. App. 1957).

138. *Id.* at 996.

139. *Id.* at 996-97; *cf.* Pioneer Oil & Gas Co. v. Anderson, 151 So. 161, 163 (Miss. 1933) ("After the corporation has refused or failed to obtain a contract with a third person he is not precluded from contracting in his own behalf with such third person.").

ognized unless the opportunity has been fully disclosed to the business.[140] The Appeals Court of Massachusetts has stated this view succinctly:

> [T]he unalterability of [a third party's] resolve can by no means be certain so long as [a fiduciary], by keeping [the third party's] position and his reasons for it a secret, never afforded [his company] a chance to test it. If the refusal to deal is shrouded in secrecy, it is too likely that the tempted officer will find himself in the position of Fielding's "fair creature" of whom he wrote, "[H]e would have ravished her, if she had not, by a timely compliance, prevented him."[141]

Therefore, under this view, before a third party's refusal to deal becomes a legitimate defense, the fiduciary "must unambiguously disclose that refusal to the corporation to which he owes a duty, together with a fair statement of the reasons for that refusal."[142]

4. *Financial Inability*

Perhaps the most controversial defense to a corporate opportunity claim is the financial inability defense.[143] Most courts will evaluate the business's financial position at the time the corporate opportunity arose.[144] If, at that time, the business is financially unable to take the opportunity, the fiduciary is permitted to take the opportunity and is not liable under the corpo-

140. *See* Chew, *supra* note 20, at 474-76 (describing cases accepting and rejecting the third party refusal to deal defense).

141. Energy Res. Corp. v. Porter, 438 N.E.2d 391, 394 (Mass. App. Ct. 1982) (quoting HENRY FIELDING, JONATHAN WILD 102 (Everyman's Library ed. 1964)) (sixth alteration in original).

142. *Id.*; *see also* Kelly v. 74 & 76 W. Tremont Ave. Corp., 151 N.Y.S.2d 900 (1956).

143. *See generally* 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).

144. *See* Orlinsky, *supra* note 44, at 461-62. *See, e.g.*, Morad v. Coupounas, 361 So. 2d 6, 9 (Ala. 1978) ("[O]ne of the factors to be considered by the trial court is the corporation's financial ability to undertake the new enterprise, although financial ability must be carefully considered and will not necessarily be determinative."); Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 156 (Del. 1996) (noting that the fiduciary "was required to consider the facts only as they existed at the time he determined to accept" the opportunity and exploit it); Fliegler v. Lawrence, No. 3647, 1974 WL 2037, *7 (Del. Ch. 1974).

rate opportunity doctrine.[145] Other courts, and a few commentators, do not recognize the financial inability defense because of its actual or perceived tendency to foster fiduciary disloyalty.

The *Guth* court implicitly recognized a financial inability defense in its definition of a corporate opportunity. The court stated that it is a prerequisite that the opportunity be one which "the corporation is financially able to undertake"[146] and found that plaintiff Loft had the financial ability to finance the project.[147] Courts that recognize a financial inability defense seem to be concerned with creating bright line rules that would prevent fiduciaries from exploiting profitable opportunities that are simply not within the financial ability of their businesses. One court illustrates this concern:

> [T]he corporation, while still maintaining its corporate existence, had clearly failed in its purposes, not only so, but it was wholly insolvent, and for some time prior to the [usurpation of the opportunity] had ceased even in an attempt to actively prosecute its business. We see no good reason why the officers and directors of such a corporation should be denied the right to make advantageous trades for themselves, when, in so doing, the interests of the insolvent, practically defunct, corporation, which they represented, are in no wise prejudiced thereby.[148]

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145. *See generally* Chew, *supra* note 20, at 472-73; Michael Begert, Comment, *The Corporate Opportunity Doctrine and Outside Business Interests*, 56 U. CHI. L. REV. 827, 833-34 (1989).

146. Guth v. Loft, 5 A.2d 503, 511 (Del. 1939); *see also* Kelegian v. Mgrdichian, 39 Cal. Rptr. 2d 390, 395 (Cal. Ct. App. 1995) ("In addition the courts may also consider whether the corporation has the financial resources to take advantage of a particular business opportunity."); *Broz*, 673 A.2d at 155; Parks v. Multimedia Tech., 520 S.E.2d 517, 524 (Ga. Ct. App. 1999); Schildberg Rock Prod., Inc. v. Brooks, 140 N.W.2d 132, 138 (Iowa 1966); *cf.* Forkin v. Cole, 548 N.E.2d 795, 808 (Ill. App. Ct. 1989) (implicitly recognizing the defense); Chem. Dynamic, Inc. v. Newfeld, 728 S.W.2d 590, 593 (Mo. Ct. App. 1987) (implicitly recognizing the defense).

147. *Guth*, 5 A.2d at 513.

148. Jasper v. Appalachian Gas Co., 153 S.W. 50, 54 (Ky. 1913). Compare a more recent case where the Rhode Island Supreme Court held that the plaintiff did not usurp a corporate opportunity because the "corporation was financially unable to avail itself of the opportunity," the defendant "then, as anyone, was able to participate in its acquisition." A. Teixeira & Co., Inc. v. Teixeira, 699 A.2d 1383, 1388 (R.I. 1997).

The burden of proving financial inability, however, is usually either implicitly or explicitly placed on the fiduciary.[149] Other courts have only recognized the defense if the fiduciary first disclosed the opportunity to the business.[150] The specific indicators of financial ability, or conversely financial inability, are not precisely articulated in the case law. But some courts require that the business be insolvent, rather than merely financially distressed.[151] The difference between technical insolvency and financial inability, however, may be a distinction without a difference.[152]

The *Miller* court, in its two-step inquiry, also evaluated financial ability in determining whether a fiduciary improperly

149. *See* Ostrowski v. Avery, 703 A.2d 117, 123 n.9 (Conn. 1997) ("[I]t is the corporate fiduciary, not the complainant, who must establish, as an affirmative defense, that the corporation lacked the financial ability to avail itself of a corporate opportunity."); Canion v. Tex. Cycle Supply, Inc., 537 S.W.2d 510, 513 (Tex. Ct. App. 1976). The *Guth* court did not explicitly articulate which party has the burden of proving financial ability or inability; it merely concluded that the corporation's "resources were found to be sufficient, for Guth made use of no other to any important extent." *Guth*, 5 A.2d at 513. Therefore, "[t]he language in *Guth* [may] impl[y] that financial ability to undertake a corporate opportunity is not only relevant, but perhaps a condition precedent to the existence of a corporate opportunity." Klinicki v. Lundgren, 695 P.2d 906, 914 (Or. 1985); *see also* Elizey v. Fyr-Pruf, Inc., 376 So. 2d 1328, 1335 (Miss. 1979) (holding that a complainant business must first show that the "business opportunity is logically related to the corporation's existing or prospective activities" and also must "prove that the corporation was either (a) not insolvent in the balance sheet sense at the relevant times, or (b) financially disabled as a result of nonpayment of a debt or breach of a fiduciary duty by one or more of the defendants").

150. Lussier v. Mau-Van Develop., Inc., 667 P.2d 804, 813 (Haw. Ct. App. 1983).

151. *See, e.g.*, CST, Inc. v. Mark, 520 A.2d 469, 472 (Pa. 1987) (stating that there "was no evidence that [the corporation] was near insolvency or that it could not have produced the funds necessary" to exploit the opportunity); Nicholson v. Evans, 642 P.2d 727, 731 (Utah 1982) (noting that "corporate financial difficulty short of actual insolvency as defined above is inadequate by itself to exonerate a fiduciary who appropriates an opportunity").

152. *See* Plas-Tex, Inc. v. Jones, No. 03-99-00286-CV, 2000 WL 632677, at *6 (Tex. Ct. App. May 18, 2000) (noting that the corporation was "insolvent, [and] in default" and therefore, "[g]iven its dire financial condition," was unable to take advantage of the opportunity); *see also* Paulman v. Kritzer, 219 N.E.2d 541, 547 (Ill. App. Ct. 1966); Elec. Dev. Co. v. Robson, 28 N.W.2d 130, 138 (Neb. 1947) ("Financial inability, unless it amounts to insolvency to the point where the corporation is practically or actually defunct, is insufficient to warrant application of the [defense]."); Orlinsky, *supra* note 44, at 462 ("Unfortunately, whether the corporation is financially able to undertake the opportunity may be a difficult, subjective determination that ultimately may be made by a judge after the fact.").

took a corporate opportunity. The court, however, placed the burden of proving financial ability on the business. In doing so, the court asked "whether the corporation, by reason of insolvency or lack of resources, has the financial ability to acquire the opportunity" and concluded that if "it lacks . . . the financial . . . ability to pursue it, then such opportunity would have to be found to be noncorporate as a matter of law."[153] If financial ability is disputed, "the question is one of fact with the burden of proof resting upon the party attacking the acquisition," or, in other words, the business must show financial *ability*.[154]

Other courts have explicitly rejected the financial inability defense. These courts generally believe that "the injection of financial ability into the equation will unduly favor the inside director or executive who has command of the facts relating to the finances of the corporation" and that the defense "will also act as a disincentive to corporate executives to solve corporate financing and other problems."[155] These courts seem to embrace a presumptive fear that fiduciaries will not exert their best efforts to improve their business's financial condition. The Second Circuit's language in *Irving Trust Co. v. Deutsch* illustrates this fear and reinforces the courts' role in policing fiduciary conduct:

> If the directors are uncertain whether the corporation can make the necessary outlays, they need not embark it upon the venture; if they do, they may not substitute themselves for the corporation any place along the line and divert possible benefits into their own pockets. "Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undi-

153. Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974). *Accord* A.C. Petters Co. v. St. Cloud Enter., Inc., 222 N.W.2d 83, 86-87 (Minn. 1974).

154. *Miller*, 222 N.W.2d at 81.

155. Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1149 (Me. 1995). *Accord* Irving Trust Co. v. Deutsch, 73 F.2d 121, 124 (2d Cir. 1934) ("If directors are permitted to justify their conduct on [a financial inability] theory, there will be a temptation to refrain from exerting their strongest efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally."); Kerrigan v. Unity Sav. Ass'n, 317 N.E.2d 39, 44 (Ill. 1974) (relying on the language in *Irving Trust*); Durfee v. Durfee, 80 N.E.2d 522, 530 (Mass. 1948) (relying on the language in *Irving Trust*); *see also* Note, *Corporate Opportunity*, *supra* note 9, at 772-73. *See generally* Brown, *supra* note 44, at 263 (describing *Irving Trust* as an example of the strict view that financial inability "is not a defense to a corporate opportunity claim").

vided loyalty by the 'disintegrating erosion' of particular exceptions."[156]

Finally, at least one court has determined that when applying the ALI test, financial inability may be examined to determine whether an interested rejection was fair.[157] Under this view, if a fiduciary properly and fully discloses an opportunity to the appropriate decisionmaker, but it is later determined that the decisionmaker was not disinterested, financial inability may absolve the fiduciary of liability because the transaction was "fair" to the business.[158] The ALI test and its corresponding comments, however, do not explicitly recognize financial inability as a defense in the absence of proper disclosure to the business.

Brudney and Clark lodge perhaps the strongest argument against the financial inability defense in proposing their unique corporate opportunity test. Brudney and Clark, contrary to the argument presented below in favor of the defense, argue that in the close corporation context "if financial disabilities . . . are accepted as tests, the inevitable result will be to permit the diversion" of the opportunity.[159] In turn, they agree with some traditional test courts that financial inability will be hard to prove after the fiduciary takes the opportunity because the "facts [are] largely within the control of the diverter."[160] They conclude, therefore, that "[t]o permit claims of disability to become the subject of judicial controversy when they can only be disproven by outsiders with great difficulty and at considerable expense is to tempt participants to actions whose impropriety is visible but rarely subject to effective challenge."[161] But they seemingly retreat from this argument later in their article, and recognize that "[t]he argument against the defense of incapacity or disability may be less forceful for close corporations than for public corporations because of the greater familiarity of the participants with the affairs of the firm, their better access to rele-

156. *Irving Trust Co.*, 73 F.2d at 124 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928)); *see also* Paulman v. Kritzer, 219 N.E.2d 541, 545 (Ill. App. Ct. 1966) (relying on *Irving Trust* in rejecting the financial inability defense).

157. Klinicki v. Lundgren, 695 P.2d 906, 919 (Or. 1985).

158. *Id.* at 920.

159. Brudney & Clark, *supra* note 42, at 1021.

160. *Id.*

161. *Id.* at 1022.

vant information, and the relative manageability of the problems."[162]

In the case of public corporations, Brudney and Clark argue that "the defense of corporate incapacity is, if anything, even less tenable . . . than it is in close corporation cases."[163] This is because the defense "inevitably depends on self-serving managerial claims that there exists no viable way to overcome the stated corporate disability; and it is virtually impossible for public stockholders to negate such claims."[164]

In sum, although courts and commentators are split regarding whether financial ability is a legitimate defense to a corporate opportunity claim, there seems to be a trend toward recognizing the defense.

5. *Individual Capacity*

The individual capacity defense is one of the longstanding recognized defenses to corporate opportunity claims; however, in modern cases its logic has been questioned, and the defense is rejected below. The defense simply asserts that a fiduciary should be able to exploit an opportunity if it is presented to him as an individual, and not as a corporate fiduciary.[165] Consequently, it is commonly asserted along with a third party refusal to deal defense. Because the opportunity is presented to the fiduciary as an individual, so the defense goes, the fiduciary should be able to take the opportunity.

The *Guth* court established a conditional individual capacity defense, requiring that when a "business opportunity comes to a corporate officer or director in his individual capacity rather than in his official capacity" the opportunity must not be "essential to [the] corporation," the corporation must not have an "interest or expectancy" in the opportunity, and the fiduciary must not have "wrongfully embarked the corporation's re-

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162. *Id.*

163. *Id.* at 1027.

164. Brudney & Clark, *supra* note 42, at 1027.

165. *See* Note, *Corporate Opportunity*, *supra* note 9, at 777 ("Where [a] third party is not shown to have had a particular expectation that the opportunity would be made available to the corporation, but merely had given the executive the option of giving it to the corporation, the executive would seem to have encountered it in his individual capacity and therefore to be under no duty to disclose.").

sources" in pursuing the opportunity.[166] The distinction between a fiduciary's individual and corporate capacity, however, is plagued by the same indeterminacy encountered with the fairness test/defense. In fact, the individual capacity defense may just be a conclusion of law for courts applying a fairness test. For example, one court has stated that "[t]he test of whether a particular opportunity is an individual or corporate one seems to be whether there was a specific duty, on the part of the officer . . . to act or contract in regard to the particular matter as the representative of the corporation—all of which is largely a question of fact."[167]

The *Miller* court recognized that although an opportunity may be corporate under its first inquiry, "whether the opportunity was presented to [the fiduciary] in his official or individual capacity" is relevant to show that the fiduciary did not violate his duty of loyalty to the business.[168] The ALI test also seemingly accepts the defense. Under the ALI test, a corporate opportunity exists when there is an

> opportunity to engage in a business activity of which a director or senior executive becomes aware . . . [i]n connection with the performance of functions as a director or senior executive, or under circumstances that should reasonably lead the director or senior executive to believe that the person offering the opportunity expects it to be offered to the corporation . . . .[169]

166. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939). *Accord* Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 155 (Del. 1996).

167. Paulman v. Kritzer, 219 N.E.2d 541, 546 (Ill. App. Ct. 1966) (citation omitted); *see also* Chem. Dynamics, Inc. v. Newfeld, 728 S.W.2d 590, 593 (Mo. Ct. App. 1987). The *Paulman* court, however, offered several factors that should be analyzed when determining whether the opportunity was individual or corporate. *Paulman,* 219 N.E.2d at 546. Two specifically address how the opportunity was presented to the fiduciary and whether corporate assets were used to exploit it:

> Whether a corporate officer has seized a corporate opportunity for his own depends not on any single factor nor is it determined by any fixed standard. Numerous factors are to be weighed, including the manner in which the offer was communicated to the officer, . . . [and] the use of corporate assets to acquire the opportunity.

Id. at 546.

168. Miller v. Miller, 222 N.W.2d 71, 81-82 (Minn. 1974).

169. ALI, *supra* note 43, § 5.05(b)(1)(A). The comment to § 5.05(b) states:

> Section 5.05(b)(1)(A) also covers opportunities that are presented to the senior executive or director under circumstances that should reasonably lead the senior executive or director to believe that the person offering the oppor-

One comment to the ALI test, however, seems to explicitly reject the defense, stating that the test "applies the doctrine of corporate opportunity to defined opportunities that come to directors or senior executives in either their individual or corporate capacity."[170] But, although the language in the comment seems to reject the defense, the ALI test may contemplate some cases where the defense is applicable.

III. A PROPOSED STATUTE

This Article's proposed statute retains a broad "*Guth*-plus" test for establishing the existence of a corporate opportunity[171] and places the burden of production for showing the existence of a corporate opportunity on the complainant business. Moreover, the proposed statute rejects both the fairness test/defense and the strict tests for corporate opportunity claims. Therefore, a fiduciary is not permitted to argue that his taking of an opportunity was fair to the business after the fact; but the test also does not require a fiduciary to disclose the opportunity to the appropriate decisionmaking body, as the strict disclosure tests mandate. Instead, if the business satisfies its initial burden of showing the existence of a corporate opportunity, the burden of persuasion shifts to the fiduciary. The fiduciary must prove by clear and convincing evidence that (1) the business consented to the taking before the fiduciary proceeded; (2) the business was not financially able to take the opportunity when it arose; or (3)

> tunity expects it to be offered to the corporation rather than taken personally. Accordingly, the focus under this provision is on *whether a reasonable person in the position of the senior executive or director would assume that an opportunity was proffered for personal or corporate benefit.* The director or senior executive has a duty of reasonable inquiry as to whether the opportunity was intended for the corporation.

Id. § 5.05(b) cmt. (b)(1) (emphasis added).

170. *Id.* § 5.05 cmt. c.

171. Professor Davis's "comparative advantage" approach may be a preferred alternative to using a "*Guth*-plus" approach to establish the existence of a corporate opportunity. Davis's main criticism of the *Guth* test rests primarily on the fact that the "traditional approach . . . focuses more on the existence of a competitive advantage at the implementation stage rather than the development stage" and therefore because his approach "favors granting the opportunity to the party with the comparative advantage at the development stage" the *Guth* standard should be modified with this goal in mind. Davis, *supra* note 19, at 267. Although this approach may be allocatively optimal, it would entail a complete overhaul of the existing corporate opportunity doctrine.

the business's decisionmaking body ratified or acquiesced to the taking after it realized the fiduciary took the opportunity for herself.

Corporate Opportunity

Subdivision 1. Applicability. This section applies to both closely held/non-public business entities and public business entities, including corporations, partnerships, and limited liability companies.

Subdivision 2. Establishing a Corporate Opportunity. A corporate opportunity is established if the complainant shows by a preponderance of the evidence that the opportunity

(a) arose out of a preexisting right, interest, or expectancy;

(b) was in the line of business;

(c) was within the avowed business purpose;

(d) was reasonably incident to the present or prospective operations; or

(e) was of practical advantage, even if the opportunity was not in the line of business.

Subdivision 3. Fiduciary Defenses. A fiduciary is not liable for a usurpation of a corporate opportunity established under subdivision 2, if it is shown by clear and convincing evidence that the

(a) decisionmaking body was disinterested, if applicable; and

(b) disinterested decisionmaking body categorically consented to the taking of the opportunity before the fiduciary proceeded, through blanket consent; or

(c) disinterested decisionmaking body individually consented to the fiduciary taking the particular opportunity; or

(d) disinterested decisionmaking body ratified the taking of the opportunity by the fiduciary after it was discovered; or

(e) business entity was financially unable to exploit the opportunity within a reasonable time after it arose; and

> (1) the fiduciary shows by clear and convincing evidence that he did not breach his duties of fidelity and diligence by failing to improve the financial ability before individually taking the opportunity.

Subdivision 4. Consent Reviewed Under Business Judgment Rule. If a complainant challenges an authorization by a decisionmaking body to permit a fiduciary to take an opportunity either by individual or blanket consent, or through after the fact ratification of the fiduciary's conduct, any such challenge shall be subject to the business judgment rule in this jurisdiction.

Subdivision 5. Corporate Opportunity Contracts. Notwithstanding any provision of this section, a business entity may, by express written agreement, alter or eliminate liability for breach of the fiduciary duty of loyalty and this section.

IV. A DEFENSE OF THE PROPOSED STATUTE

In this Part, the proposed statute is defended, based on the hypothetical contract model expounded in Part II. One note, however, before we begin. Trying to pigeonhole a particular fiduciary defense into a hypothetical contract model has minor drawbacks. One of these drawbacks is a certain level of speculation. As Professor Chew correctly recognizes, courts (and this Article) should use particular guidelines when assessing whether a fiduciary defense is consistent with a hypothetical contract model. As Professor Chew states:

> 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. . . . [T]he corporate-fiduciary relationship is more analogous to an agency, employee, or partnership relationship where the duties and rights of both parties are recognized and flexibility negotiated. . . .
> 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 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.[172]

A. *Rejection of the Close Versus Public Distinction*

Although some commentators suggest that courts should treat corporate opportunity claims differently depending on whether the business is public or private,[173] such a distinction,

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172. Chew, *supra* note 20, at 493 (footnotes omitted).
173. *See supra* text accompanying notes 67-78.

though possibly analytically defensible, results in more confusion in an already confusing area of law.[174]

Understandably, most corporate opportunity claims arise in the close corporation context[175] where fiduciaries are uniquely privy to new opportunities that could easily be exploited by the business. When these opportunities are presented, fiduciaries are most likely less informed than their public corporation counterparts about the restrictions of the corporate opportunity doctrine, and, in particular, the scope of their duty of loyalty to their closely held business. In contrast, it is safe to assume that public corporation officers and directors have a better understanding of their fiduciary duties to their businesses. If a different rule is justified for public officers and directors, such a rule must assume the premise that public officers and directors are more predisposed to take corporate opportunities.[176] Common sense suggests that public officers and directors will not jeopardize their lucrative positions at public corporations, and any future corporate employment, in an attempt to cash in by taking a lone corporate opportunity for themselves.[177]

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174. Professor Talley also criticizes the public versus private distinction on technical efficiency grounds. According to Talley

> categorical prohibition [is] somewhat extreme. In particular, even if ownership structure is a good proxy for information asymmetry, it does not follow that categorical prohibition is the best judicial response. On the contrary, . . . information asymmetries actually provide a rationale for *instituting* incentive schemes, which by nature may consciously permit the fiduciary to divert at least some projects for her own account.

Talley, *supra* note 17, at 284.

175. *See* Brudney & Clark, *supra* note 42, at 1061 (noting "that the formulation of corporate law doctrines by state courts has been *pervasively* influenced by the fact that the overwhelming majority of corporate cases coming before state courts have involved close corporations"); Begert, *supra* note 145, at 853 ("Since most corporate opportunity cases involve closely held corporations, the corporate opportunity rule for close corporations is, in many ways, the corporate opportunity doctrine."). But remember, however, that corporate opportunity claims also may play a significant role in large corporate transactions. *See supra* note 117.

176. *See* Talley, *supra* note 17, at 352 ("[T]o the extent that ownership structure is an indirect proxy for information structure, legal distinctions between public and close corporations appear to be justified.").

177. It is interesting that Brudney and Clark are so skeptical of the loyalty of public officers and directors when one considers the career impact of leading a public corporation into financial distress to "steal" a corporate opportunity. Brudney and Clark hypothesize that any corporate incapacity defense "tempts the officers to fail to exercise their best efforts to make the corporation able to overcome

B. *Rejection of Strict Disclosure*

Noticeably, and contrary to the recent trend,[178] the proposed statute does not require a fiduciary to disclose an opportunity to his business before taking it.[179] The statute rejects strict disclosure because it may unduly discourage economic innovation and decrease allocative efficiency. The statute also rejects the categorical prohibitions proposed by Brudney and Clark, in the case of public corporations.[180]

The Delaware Supreme Court in *Broz v. Cellular Information Systems* succinctly articulated why a fiduciary should be permitted limited defenses, particularly the financial inability defense, under the corporate opportunity doctrine. The court's underlying rationale is equally relevant when formulating a statute that does not require per se disclosure to a decisionmaking body:

> [Defendant] was entitled to proceed in his own economic interest in the absence of any countervailing duty. The right of a director or officer to engage in business affairs outside of his or her fiduciary capacity would be illusory if these individuals were required to consider every potential, future occurrence in determining whether a particular business strategy would implicate fiduciary duty concerns. In order for a director to engage meaningfully in business unrelated to his or her corporate role, the director must be allowed to make decisions based on the situation as it exists at the time a given opportunity is presented. Absent such a rule, the

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the disability." Brudney & Clark, *supra* note 42, at 1027. The author is skeptical of this view, and, in fact, the opposite may be true in most cases. Butler and Ribstein observe:

> Corporate managers recognize that they can improve the performance of the firm by reducing agency costs. Managers compete with one another to attain the top positions in their companies, and most promotion decisions are made on the basis of an individual's productivity . . . . Thus, competition for managerial services, both inside and outside the corporation, encourages managers to act in shareholders' best interests.

Butler & Ribstein, *supra* note 30, at 27.

178. *See supra* Section B of Part II (discussing the strict disclosure requirements of the Brudney and Clark and ALI approaches).

179. Of course, disclosure should create a "safe harbor" for a risk adverse fiduciary. *See* Ostrowski v. Avery, 703 A.2d 117, 128 (Conn. 1997) ("adequate disclosure . . . is an absolute defense to fiduciary liability"); Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 157 (Del. 1996) (presenting the opportunity creates a "safe harbor" for the fiduciary).

180. *See supra* text accompanying notes 76-78.

> corporate fiduciary would be constrained to refrain from exploiting any opportunity for fear of liability based on the occurrence of subsequent events. This state of affairs would unduly restrict officers and directors and would be antithetical to certainty in corporation law.[181]

Simply put, and in line with this reasoning, strict disclosure potentially inhibits fiduciaries from exploiting profitable opportunities that a business does not have the ability to exploit, by creating a process where the business has the ability to prevent the fiduciary from exploiting the opportunity.

The principal shortcoming of the strict disclosure/categorical prohibition tests[182] is that if a fiduciary is presented with an opportunity that is profitable, yet at the same time fleeting, a business that is not financially able to take the opportunity may be able to claim the opportunity for itself and "store it away,"[183] presumably for expected future exploitation.[184] Meanwhile, the opportunity may be lost to an equally efficient competing business, it may be exploited inefficiently by another business, or it may not be exploited at all.[185] In the first two cases both the

181. *Broz,* 673 A.2d at 159.

182. One may assume the strict disclosure tests provide fiduciaries, businesses, and courts with absolute certainty and predictability to guide their conduct. In practice, such certainty may be illusory. As Professor Chew notes, "[u]nresolved 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." Chew, *supra* note 20, at 483.

183. The *Northeast Harbor Golf Club* court did not recognize this potential problem when it adopted the ALI's strict disclosure test; instead, the court noted that disclosure "protects the fiduciary's ability pursuant to the proper procedure to pursue her own business ventures free from the possibility of a lawsuit." Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1152 (Me. 1995). Although the ALI test protects fiduciaries from potential lawsuits, it also may prevent them from taking any opportunity, even when their business entity is financially unable to exploit new opportunities, making any "protection" of strict disclosure nugatory.

184. The strict disclosure tests such as the ALI test also may "create[ ] moral hazards for disinterested participants. It may, for example, allow a participant to risk funds on several investments without obtaining a rejection, perhaps believing that rejection is not necessary. Then, when certain of the investments prove to be fruitful, other disinterested participants can claim them for the corporation. In this way the corporation reaps the benefit without assuming any of the risk." Begert, *supra* note 145, at 848.

185. Brudney and Clark argue otherwise. For instance, in defending their categorical denial of opportunities for public fiduciaries, they argue "most foregone opportunities will be exploited by third parties." Brudney & Clark, *supra* note 42,

business and the fiduciary lose and in the latter two, society loses.

A business has many reasons to force a fiduciary to disclose a potential opportunity, even when the business is unable to take the opportunity in the short-run. For instance, it may believe that its financial situation will quickly improve, and it has no reason to disfavor third party exploitation of the opportunity over the benefit to its fiduciary. In both instances, the business is not competitively harmed. The fiduciary and society, however, are potentially harmed from requiring strict disclosure. The fiduciary may have the requisite skills to exploit efficiently the opportunity. Indeed, if the opportunity comes to a fiduciary in a certain type of business, the fiduciary likely will have more than adequate skill to develop and implement the opportunity, if the opportunity is related to her employment.[186] Contrary to the established bureaucracy of large businesses, "fiduciaries [can] 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."[187] Furthermore, even if a business does not "store away" the opportunity, the process of obtaining *ex ante* consent from a disinterested decisionmaking body may itself be lengthy, which also could result in the same inefficient outcomes described above.[188]

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at 1029. The plausibility of this statement must be based on an assumption that all opportunities are widely known to exist.

186. Contrary to Professor Chew's analysis of the disadvantages of the strict disclosure tests, this Article does not recognize her concern about a fiduciary's right to confidentiality; although her concern noticeably stems from a situation where a fiduciary is preparing to leave her business to exploit an opportunity. *See* Chew, *supra* note 20, at 482-84. To be sure, a fiduciary should not be required to disclose her plans to leave her business and exploit an opportunity. *Cf. generally* Midwest Janitorial Supply Corp. v. Greenwood, 629 N.W.2d 371 (Iowa 2001). If, however, the fiduciary plans to remain with the business and simultaneously exploit an otherwise corporate opportunity, the fiduciary should not be shielded from disclosure by an abstract notion of a "right to confidentiality."

187. Chew, *supra* note 20, at 453; *cf.* Begert, *supra* note 145, at 848 ("[T]he strict rule creates a powerful disincentive for small businesspeople to participate in closely held corporations, thereby diminishing the value of the closely held corporation as an organizational form.").

188. *See* Chew, *supra* note 20, at 483; *see also* Begert, *supra* note 145, at 859-60 (noting that requiring formal rejection of opportunities that are clearly outside current business activities "would invite opportunistic behavior by disinterested participants without providing any legitimate protection to the corporation. . . .

Defending the rejection of a strict disclosure requirement under a hypothetical contract model, however, is a more difficult task. Admittedly, this analysis slightly differs from a hypothetical contract analysis of the financial inability defense described below. Here, a hypothetical contract analysis asks whether the parties would have contracted for strict disclosure if the parties had contemplated the circumstances *ex ante*. Below, however, the hypothetical contract analysis asks whether the business and the fiduciary would have expressly contracted to permit a fiduciary to take a corporate opportunity if the business was financially unable to take the opportunity.

Therefore, here the crucial question is: If the fiduciary and the business could have foreseen a circumstance where a corporate opportunity arose, would the parties have agreed that the fiduciary need not be strictly required to disclose the opportunity to the business? On the one hand, the business may want to contract expressly for such a requirement because it may believe *ex ante* that it should be the only party to decide, at least initially, whether it wants to pursue the opportunity. But, it may be equally likely that the business would be indifferent to requiring a fiduciary to disclose a potential opportunity because it may believe that in such situations all efforts should be directed at improving its existing operations. Remember, the statute only permits a fiduciary to take a corporate opportunity, absent consent, if the business is financially unable to exploit it.

Under this hypothetical contract analysis, therefore, it is indeterminate whether a business would expressly contract for a strict affirmative obligation of the fiduciary to disclose a potential opportunity if the business is financially unable to exploit the opportunity. In light of the offsetting probability of a highly inefficient outcome in many cases as described above, the proposed statute adopts the more efficient rule of not requiring strict disclosure.

[Such a requirement] may be pointless and wasteful as well as an invitation to hold out during a rejection vote.").

C. *Burden Shifting: Establishing the Existence of a Corporate Opportunity by a Preponderance of the Evidence & Requiring the Fiduciary to Rebut With Clear and Convincing Evidence*

Although the proposed statute places the initial burden of showing the existence of a corporate opportunity on the business, it retains the relatively lenient *Guth* test for establishing a corporate opportunity and extends it by permitting the business to show that the opportunity would have been of practical advantage to it, even though the opportunity was not technically in the business's line of business.

Placing the burden of showing that the opportunity was sufficiently corporate on the business is in line with the majority of case law[189] and academic commentary,[190] and it makes logical sense. A business should not be permitted to bring corporate opportunity claims against its present or former fiduciaries unless it reasonably believes that the opportunity was one that the business would have (and could have) taken and exploited.[191]

Although the burden of production is placed on the business to show by a preponderance of the evidence that an opportunity was sufficiently corporate, the burden should be relatively easy to satisfy. There are many ways an opportunity can be adapted to a business's existing operations, even though the opportunity may not have been previously contemplated.[192]

189. *See, e.g.,* Ostrowski v. Avery, 703 A.2d 117, 121 (Conn. 1997) ("[The] plaintiff bears the burden of establishing: (1) a fiduciary relationship between the corporation and the alleged wrongdoers; and (2) the existence of a corporate opportunity."); Phoenix Airline Serv. v. Metro Airlines, 397 S.E.2d 699, 702 (Ga. 1990) ("The burden of proof with regard to [establishing a corporate opportunity] rests upon the party attacking the acquisition."); *see also supra* note 45 and accompanying text.

190. *See* Begert, *supra* note 145, at 851 (placing the initial burden in his proposed rule on the business). *But see* Brudney & Clark, *supra* note 42, at 1016 ("The intrinsic ambiguity of the [interest and expectancy] concepts suggests, as in the case of determining whether opportunities are functionally related, that the burden be placed on the challenged fiduciary to prove the absence of an interest or expectancy.").

191. *See* Orlinsky, *supra* note 44, at 521. Orlinsky argues that "[i]nitially, the burden of proof rests on the challenger, who must establish that a corporate opportunity exists." *Id.*

192. Brudney and Clark forcefully assert this argument in the context of public corporations, Brudney & Clark, *supra* note 42, at 1025, but the author does not

Therefore, any opportunity that does not clearly fall outside a business's existing operations, or beyond its ability to modify those operations, should be classified as a corporate opportunity as a matter of law.[193]

The proposed statute places the ultimate burden of persuasion on the fiduciary if the business satisfies its burden of production. Raising a fiduciary's burden of persuasion from a preponderance of the evidence to a clear and convincing standard[194] may deter more fiduciaries from taking opportunities, but this standard also is in line with the general purpose of the proposed statute: providing adequate protection for businesses while at the same time discouraging businesses from storing away opportunities until they are financially able to exploit them.

D. *Rejected Fiduciary Defenses*

The proposed statute also excludes by omission four fiduciary defenses because they do not necessarily facilitate economic innovation and allocative efficiency, and because they are inconsistent with a hypothetical contract theory of the duty of loyalty. The rejected defenses are the fairness test/defense, the legal inability defense, the third party refusal to deal defense, and the individual capacity defense.

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accept their argument that a corporate opportunity exists whenever an opportunity "will produce a risk-adjusted rate of return at least matching that of its current operations." *Id.* The professors note, consistent with the proposed statute, that

> [o]ne may fairly question why courts should presume a publicly held corporation to be confined to the line or lines of business in which it currently operates. Why should it be assumed that an enterprise that starts out in the electronics business is precluded from moving profitably into the beer-bottling business? Diversification commends itself to financial theorists as a way to increase investment returns per unit of risk . . . .

Id. at 1026.

193. *See* Note, *Corporate Opportunity*, *supra* note 9, at 769 ("Although the line begins to become unclear [under the line of business test], a sufficiently close link to current operations should be required so that an executive has adequate guidance in shaping his course of action.").

194. *See Ostrowski*, 703 A.2d at 128.

1. *Fairness*

As stated earlier, the fairness test/defense affords courts too much discretion to decide corporate opportunity claims on amorphous, unpredictable equitable considerations[195] and this "discretion generates much uncertainty about the operational meaning of the legal rule, [while generating] no offsetting benefits."[196] Fairness defenses such as the *Miller* court's hopelessly open-ended inquiry into "all other facts and circumstances bearing on the officer's good faith and whether he exercised the diligence, devotion, care, and fairness toward the corporation which ordinarily prudent men would exercise under similar circumstances in like positions" do not provide any guidance to fiduciaries when they consider taking opportunities; nor do they provide a business with any guidance when determining whether it will prevail on a corporate opportunity claim.[197]

The fiduciary and the business are not able to order their economic behavior and make decisions based on relatively understandable and predictable rules and standards. What is fair to one appellate court panel of judges may not be fair to another panel, even though the two are sitting for oral argument on the same day. Such indeterminacy should not be tolerated and is rejected by the proposed statute.

The fairness test/defense also is inconsistent with a hypothetical contract theory of the duty of loyalty. It is unlikely, and perhaps incredulous, that a business and fiduciary would expressly contract for a fairness standard to determine whether the fiduciary has usurped a corporate opportunity. Expressly contracting for such a standard to resolve corporate opportunity disputes would be inefficient and impracticable.

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195. *See supra* Section C of Part II.

196. Brudney & Clark, *supra* note 42, at 1020.

197. *See* Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1150 (Me. 1995) (noting that the *Miller* "fairness" inquiry "piles the uncertainty and vagueness of the fairness test on top of the weaknesses in the line of business test"); *see also* Talley, *supra* note 17, at 295 (noting that the "shortcomings [of the fairness defense] have, in part, led commentators and courts to proclaim that the fairness test as applied to the [corporate opportunity doctrine] merely muddies the waters, adds new layers of confusion to already murky doctrine, and provides no predictable guidelines. Consequently, the fairness test has held only modest sway within courts and among academics" (citations omitted)).

2. *Legal Inability & Third Party Refusals to Deal*

Although it also is commonly recognized as a legitimate defense to corporate opportunity claims,[198] the legal inability defense also is unsatisfactory and rejected by the proposed statute because in most cases a business can take affirmative steps to remedy any legal impediment to exploit an opportunity, if the opportunity is initially disclosed to the appropriate decisionmaking body.[199] After disclosure, the dispositive question would be whether the business "could have overcome the [legal] disability by amending [its] charter or securities registration statement, by forming a subsidiary, or by procuring revocation of the offending legislation."[200] This inquiry should properly be resolved by the business, and should not be decided by the fiduciary who may or may not be in a position to determine impartially the feasibility of remedial measures.[201] Therefore, absent adequate disclosure to the appropriate decisionmaking body, the fiduciary should not be able to assert a legal inability defense after the fact.[202]

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198. *See supra* Section C of Part II.

199. *See* Kerrigan v. Unity Sav. Ass'n, 317 N.E.2d 39, 43-44 (Ill. 1974). *Contra* Begert, *supra* note 145, at 852.

200. Brudney & Clark, *supra* note 42, at 1022.

201. *Cf.* Note, *Corporate Opportunity*, *supra* note 9, at 773-74.

> Any exception for bylaw obstruction to corporate action is also of dubious desirability, if the bylaws can be amended by the directors themselves. Since the directors can modify the bylaws simultaneously with a decision to act on the opportunity, a corporate decision need not be unduly delayed. And while an executive may be entitled to measure his obligations by the relatively stable limitations of law and charter provisions, permitting a comparable reliance on the transitory provisions of the bylaws seems highly prejudicial to legitimate corporate interests and out of tune with the reasonable expectations of the corporate employer.

Id. David Brown makes a similar argument:

> The defense of legal disability puts the diverting fiduciary in the initial position of determining the legality or illegality of the corporation engaging in a particular activity. Given the fiduciary's self interest in finding that it is not legal . . . the likely outcome of his decision is clear. Moreover, in many instances a legal disability can be corrected by amending a by-law or creating a subsidiary to engage in a business in which the parent company is not allowed to engage.

Brown, *supra* note 44, at 265.

202. The Supreme Judicial Court of Massachusetts has whole-heartedly rejected the legal inability defense, as well as the financial inability defense. Although the author disagrees with the court's rejection of the financial inability

This view also comports with the promotion of allocative efficiency and economic innovation. If a business is only precluded from profitably taking an opportunity by a technical bylaw provision or by operation of law, it is likely efficient to allow the business to attempt to change such legal and regulatory impediments—provided that the attempt be made within a reasonable time.

Rejecting the legal inability defense also is consistent with a hypothetical contract analysis. If the business and fiduciary had contemplated circumstances where an opportunity was presented to a fiduciary and where the business was not legally able to take it, the business would likely insist that the fiduciary disclose the opportunity thereby allowing the business sufficient time to rectify the legal or regulatory impediment.[203]

Similarly, the unwillingness of a third party to deal with a business should not be permitted as a defense to a corporate opportunity claim, absent disclosure. This defense also is rejected mainly because it presents significant evidentiary problems. For example, if a fiduciary and a third party (who presented the opportunity to the fiduciary) are successful in their independent collaboration, it would not be in either party's interest to admit later that the third party also was interested in working with the business at the outset. Such an admission could establish, as a matter of law, the existence of a corporate opportunity, and, in turn, lead to the imposition of a construc-

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defense, the court's discussion when rejecting the legal inability defense is instructive:

> [T]o ensure fairness to the corporation, opportunities must be presented to the corporation without regard to possible impediments, and material facts must be fully disclosed, so that the corporation may consider whether and how to address these obstacles. . . . Without such a rule, the fiduciary's self-interest may cloud his judgment or tempt him to overlook his duties.

Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 181 (Mass. 1997).

203. This is similar to the argument Professor Talley makes in proposing an information based corporate opportunity theory. *See* Talley, *supra* note 17, at 351. Talley suggests that in cases where "private" information is only available to the diverter, even diversion of opportunities that lie far outside the business's line of business should be proscribed because of the informational asymmetry between the fiduciary and the business. *See id.* at 351-52; *see also* Note, *Corporate Opportunity*, *supra* note 9, at 774 (noting that permitting a by-law obstruction that can be easily remedied by the board of directors to absolve a fiduciary from liability "seems highly prejudicial to legitimate corporate interests and out of tune with the reasonable expectations of the corporate employer").

tive trust on the fiduciary's interest in the diverted opportunity in favor of the business. Therefore, "if third parties show an unwillingness to deal with the corporation, [the fiduciary] should disclose this fact and attempt to cure the problem."[204]

The proposed statute's rejection of the third party refusal to deal defense also is consistent with the promotion of economic innovation and allocative efficiency, as well as with a hypothetical contract analysis, for the reasons stated above in rejecting the legal inability defense.

3. *Individual Capacity*

The proposed statute also rejects the individual capacity defense. This defense is rejected for much of the same reasons asserted above in the third party refusal to deal context: there are significant evidentiary problems associated with showing that an opportunity was presented to a fiduciary in his individual capacity. Furthermore, a corporate fiduciary is always subject to the duty of loyalty; therefore, he is under a constant duty to promote the interests of his business, even if an opportunity is arguably presented to him in his individual capacity.[205]

If the defense were permitted, what would be an objective standard for whether an opportunity was presented to the fiduciary in his individual capacity as opposed to his corporate capacity?[206] Any after the fact inquiry would be problematic for a

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204. Begert, *supra* note 145, at 835. Professor Chew correctly notes that in cases where there is a third party refusal to deal and where any action by the business could not influence the third party, the fiduciary should be permitted to take the opportunity, assuming there is full disclosure. *See* Chew, *supra* note 20, at 476.

205. *But see* Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 155 (Del. 1996) (noting that one of the dispositive factors in the case was "that Broz became aware of the . . . opportunity in his individual and not his corporate capacity").

206. Professor Davis succinctly summarizes the inherent problems with the individual capacity defense when discussing *Northeast Harbor Golf Club, Inc. v. Harris*:

> Why should it matter . . . whether the broker approached Harris as the club's president rather than as an individual? It was not as if he was the holder of some special benefit that he sought to confer on the club alone. Real estate brokers are not generally in the business of philanthropy. His job was to get the best deal for his client. Had he possessed more complete information and anticipated Harris's personal interest in the property, he presumably would have approached her in her individual capacity as well. . . . It seems strange, therefore, to make Harris's fiduciary duty turn

court because the only parties privy to that type of information would be the fiduciary and the party who approached her with the opportunity.[207] Not surprisingly, both parties, if successful, would claim that the third party presented the opportunity to the fiduciary because the fiduciary was a friend or acquaintance, not the fiduciary of a particular business.

Finally, a fiduciary is a fiduciary twenty-four hours a day, seven days a week—at least for full-time executives.[208] When an opportunity is presented to the fiduciary in any manner, she should disclose the opportunity to the business first, and if it rejects the opportunity, then she may take it.[209]

> on what the broker happened to know at the outset about her personal investment preferences.

Davis, *supra* note 19, at 260.

207. *See* Gelb, *supra* note 58, at 400 (noting that probable evidentiary problems with the individual capacity defense dictate that "a director should be held to a high standard of fiduciary responsibility no matter how he or she becomes aware of certain opportunities"). For this reason a third party refusal to deal defense also may be accompanied by the defense that the opportunity was presented to the fiduciary as an individual. *See supra* Section C of Part II.

208. This proposition may be tempered in the case of outside corporate directors. In such a case, rejection of the individual capacity defense may be unwarranted in light of a hypothetical contract analysis. As one commentator writes:

> A reasonable outside director, for example, would not give up all interests upon agreeing to work for [a] company, nor would the company expect the director to do so. Many outside directors have significant interests in the same industry. . . . By assuming positions as fiduciaries, moreover, officers and directors have not relinquished all rights to pursue personal opportunities made available to them. Such a rule would amount to corporate slavery, considerably increasing the salaries corporations would have to pay fiduciaries to work for the company.

Fielding, *supra* note 18, at 225; *see also* ALI, *supra* note 43, § 5.05 cmt. c, illus. 1 (noting that "under § 5.05 directors who are not senior executives have no obligation to offer an opportunity to the corporation simply because the opportunity is closely related to the corporation's business").

209. *But see* Miller v. Miller, 222 N.W.2d 71, 81-82 (Minn. 1974) (noting that "whether the opportunity was presented to [the fiduciary] in his official or individual capacity" is a relevant factor under its "fairness" inquiry); Solimine v. Hollander, 16 A.2d 203, 215-18 (N.J. Ch. 1940) (finding that the opportunity came to the defendants in their individual capacity); Note, *Corporate Opportunity*, *supra* note 9, at 777 ("Where the third party is not shown to have had a particular expectation that the opportunity would be made available to the corporation, but merely had given the executive the *option* of giving it to the corporation, the executive would seem to have encountered it in his individual capacity and therefore to be under no duty to disclose." (emphasis added)).

E. *Accepted Fiduciary Defenses*

The proposed statute accepts three fiduciary defenses to corporate opportunity claims. First, the statute permits a fiduciary to assert that the business, either through a blanket provision in a corporate instrument or individually, consented to the fiduciary's taking of an opportunity before he personally took it. Business consent may come in the form of an affirmative grant of the opportunity by a disinterested decisionmaking body to the fiduciary. Business consent also may be implied from the circumstances if the decisionmaking body did not expressly object, after disclosure, within a reasonable time, taking into account a typical time-frame for corporate decisionmaking. Second, the fiduciary may assert that the business was financially unable to take an opportunity at the time it arose, provided that the fiduciary complied with his duties of fidelity and diligence in attempting to resolve the business's financial problems. Finally, a fiduciary may assert that a decisionmaking body ratified (or, to put it another way, consented to or ratified after the fact) the fiduciary's taking of an otherwise corporate opportunity.

These three defenses are retained by the proposed statute because they are consistent with the statute's goal of promoting economic innovation and allocative efficiency, but, more importantly, because the defenses are consistent with a hypothetical contract theory of the duty of loyalty without undermining the duty of loyalty as a substantive restraint on fiduciary conduct.

1. *Individual or Blanket Consent*

As described in Part II, most courts and commentators[210] permit a fiduciary to take a corporate opportunity if the fiduciary first discloses the opportunity to the relevant decisionmaking body and receives affirmative consent from that body to take the opportunity.[211] Affirmative *ex ante* consent by the business promotes economic innovation and allocative efficiency be-

210. *See* Orlinsky, *supra* note 44, at 521 (stating that the fiduciary must rebut a showing that a corporate opportunity exists by proving financial inability "or that the opportunity, after full disclosure to the board or stockholders, was rejected").

211. *See* Note, *Corporate Opportunity*, *supra* note 9, at 774 ("Placing the burden of proving full disclosure upon the executive and requiring disinterested rejec-

cause if the business decides not to exploit a particular opportunity, it likely would not have been the most efficient exploiter of the opportunity.[212] Moreover, permitting an affirmative consent defense is consistent with a hypothetical contract analysis because it is in one sense an express agreement: the fiduciary and the business have contemplated the opportunity after full disclosure and have mutually agreed that the fiduciary should be permitted to take the opportunity.[213]

The more difficult question is whether a consent by non-activity defense should be permitted under the proposed statute. A consent by non-activity defense permits a fiduciary to take a business opportunity if she presents the opportunity to the relevant decisionmaking body, and that body fails to expressly consent or deny consent to the fiduciary.[214] The proposed statute accepts this defense if the relevant decisionmaking body fails to take action within a reasonable time, taking into account, of course, normal and reasonable timetables for corporate decisionmaking. What the timetable would be in each particular case would have to be, perhaps unsatisfactorily, based on the facts and circumstances of each case.

Any indeterminacy created by a fact-based inquiry into the reasonableness of a failure to affirmatively consent to or reject an opportunity is significantly outweighed by efficiency concerns. One of the goals of the proposed statute is allocative efficiency, and a decisionmaking body should bear some responsibility to decide as quickly as possible whether the business will take an opportunity. Otherwise, inefficiency may result for the same reasons strict disclosure impedes innovation: the business may store away the opportunity by failing to make an affirmative decision to accept or reject the opportunity.

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tion seem sufficient assurances that corporate interests have received adequate consideration.").

212. *But cf.* Brown, *supra* note 44, at 276 (arguing that in the close corporation context both board rejection and "unanimous shareholder consent should be required to allow a corporate fiduciary to develop a corporate opportunity on an individual basis" because "rejection of a corporate opportunity is a waste of corporate assets").

213. *See* Fielding, *supra* note 18, at 226 (noting that the consent defense "demonstrates the contractual foundation of the [corporate opportunity] doctrine, suggesting that the duty of loyalty can be relaxed if the parties agree to do so").

214. *See supra* note 115 and accompanying text.

Permitting a consent by non-activity defense also comports with a hypothetical contract analysis. If the business and fiduciary could foresee the circumstances, the business would likely require the fiduciary to disclose the opportunity for acceptance or rejection; but the fiduciary would likely insist that if the decisionmaking body did not act within a reasonable time, the fiduciary could take the opportunity for herself.

Finally, blanket consent also is accepted as a fiduciary defense. Under this defense, a fiduciary is absolved from liability under the corporate opportunity doctrine if the business consents to her taking by providing for such circumstances in its articles of incorporation, its by-laws, through corporate resolution, or through a similar corporate instrument.[215] Permitting this defense, as Delaware now does in both its corporate and LLC statutes,[216] promotes allocative efficiency because if the business decides to disclaim any interest in a particular type of opportunity *ex ante*, it likely is not the best-equipped firm to develop and implement these types of opportunities. Moreover, permitting a blanket consent defense is consistent with a hypothetical contract analysis because it is really an express contract between the business and its fiduciaries,[217] and such

215. *See supra* note 116-17 and accompanying text; *cf.* Brudney & Clark, *supra* note 42, at 1019 ("[T]he burden should be on the diverter to prove for other opportunities [not contemporaneously consented to] that the particular diversion was originally consented to by the founding venturers."). *But see, e.g.*, MINN. STAT. § 302A.241, subd. 4 (1985) ("The articles [of incorporation] shall not eliminate or limit the liability of a director . . . for any breach of the director's duty of loyalty to the corporation or its shareholders . . . .").

216. See *supra* text accompanying notes 116-17 for a description of the recent legislation adopted in Delaware that permits the relaxation of the duty of loyalty for corporate fiduciaries. *See generally* Cohen, *supra* note 28, at 459-64 (noting the various LLC statutes that take a deferential view to enforcing a strict duty of loyalty).

217. Richard Booth criticizes partnership statutes that provide for total waiver of fiduciary duties. These statutes, according to Booth, lead to *no* bargaining between parties over the scope of fiduciary duties. Booth, *supra* note 29, at 61. Consequently, "[p]artial waiver, no matter how closely it approaches total waiver, requires the person with information as to likely conflicts to disclose those conflicts and to seek advance approval from the other partners. Total waiver in the absence of specification allows a partner who expects a conflict simply to demand a total waiver." *Id.* at 64 (citation omitted). Although this argument has some merit, it still accepts the normative assumption that businesses and their fiduciaries are not rational and competent to contract expressly with each other to define their relationship. Such an assumption, therefore, suffers from the same infirmities as

provisions give notice to investors and creditors regarding the scope of the business's fiduciaries' duty of loyalty.

Acceptance of a blanket consent defense would bring corporations law into line with the statutory rights of partners and LLC members who currently enjoy relatively wide latitude to define their rights and responsibilities vis-a-vis their business through express contract.[218] Assuming, at least in the case of a public entity, that the market for its securities is relatively informationally efficient, blanket consent provisions, if relevant to the future cash flows of the firm, will permit present and future investors and creditors to discount the value of the business accordingly.[219]

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the traditionalist arguments for enforcing a strict view of the duty of loyalty, namely, to equalize the parties' relative bargaining power.

218. This is not to say that more could not be done to eliminate restrictions, particularly in the Revised Uniform Partnership Act, which still significantly limit the ability of partners and their partnership to waive completely *ex ante* the duty of loyalty in agreed on situations. *See, e.g.*, Larry E. Ribstein, *The Revised Uniform Partnership Act: Not Ready For Prime Time*, 49 BUS. LAW. 45 (1993). Ribstein correctly notes that the statutory "qualifications are so vague that sophisticated planners would be foolish to rely on them, but are sure to enmesh in litigation unfortunate partners who attempt private ordering of fiduciary duties." *Id.* at 60. For an example of a state statute that has thrust these provisions on existing partnerships, perhaps without their knowledge, see MINN. STAT § 323A.12-02 (requiring the Minnesota Revised Partnership Statute to govern all partnerships after January 1, 2002); § 323A.1-03 (prohibiting the elimination of the duty of loyalty with strict exceptions).

The relative freedom to contract also is recognized by those commentators who would retain specific limitations on waiver or modification of fiduciary duties in the LLC context. For instance, Professor Sandra Miller recognizes:

> The growing movement away from the judicial implication of broad fiduciary duties makes it increasingly important for the minority LLC member to obtain express contractual protections . . . including a default buy-out right and possibly a dissolution remedy. Practitioners' sentiments against judicial monitoring of private enterprises are dramatically changing the business law landscape and should not be taken lightly.

Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company*, 38 HARV. J. ON LEGIS. 413, 450 (2001). Miller, however, advocates enacting statutory protections that would prohibit LLCs from unreasonably restricting or reducing fiduciary duties or the standard of care primarily to protect the interests of minority owners because of the "considerable uncertainties surrounding the judicial interpretation of the duty of loyalty." *Id.* at 460.

219. Of course, this assumes the securities markets are relatively informationally efficient. As Butler and Ribstein note,

> Where [waivers of fiduciary duties] are enforced against shareholders who buy into the corporation after the waiver is enacted, it is clear that the basic

Finally, blanket consent through express *ex ante* agreement seems to be the only way to address the inherent conflict necessarily experienced by a director who sits on two different boards. *Ex ante* blanket consent would provide relative certainty for both the director and each business by defining the director's fiduciary duties vis-a-vis each entity.[220]

2. *Financial Inability*

The proposed statute also retains a limited financial inability defense,[221] but the fiduciary must prove that she complied with her fiduciary duties of fidelity and diligence to improve the financial condition of the business, if distressed, when the opportunity arose. The defense permits a fiduciary to take an opportunity if her business is financially distressed, with little or no hope of recovery. It does not require the business to be insolvent; rather, it requires the fiduciary to exercise her duties of fidelity and diligence to improve the business's financial condition to permit it to exploit the opportunity.[222]

> question is one of pricing: in light of the Efficient Capital Markets Hypothesis, differences between corporations regarding management duties and the potential for managerial misconduct are reflected in the prices of the securities of those companies. This efficient market pricing provides pressure toward development of optimal contract terms, including the optimal reliance on legal constraints such as fiduciary duties.

Butler & Ribstein, *supra* note 30, at 6 (citation omitted).

220. *See* John G. Finley, *Corporate Governance Issues Related to Strategic Investments in Public Companies*, 10 U. MIAMI BUS. L. REV. 15, 27 n.38 (2002). Finley notes:

> A possible way to deal with corporate opportunity problems raised by the presence of a director on the boards of both the strategic investor and of the public company vehicle is for the parties to define carefully the scope of the directors' fiduciary duties with respect to corporate opportunities in the charter of the vehicle: "[T]here is no reason why corporate charters cannot contain provisions dealing with corporate opportunities or dealing with the ability of officers or directors to compete with the corporation. . . . The treatment of 'corporate' opportunities by a managing person or entity (or person controlling one) is a rather prominent candidate for explicit contracting . . . ."

Id. (citation omitted) (alteration in original).

221. *Accord* Begert, *supra* note 145, at 851.

222. *But see* Brown, *supra* note 44, at 264. Brown notes:

> When the fiduciary decides that the corporation is financially unable to take the opportunity, he is substituting his own judgment for that of the board of directors or shareholders. Only when the corporation is insolvent is financial ability so palpably clear that the law should allow a fiduciary to deter-

Although some criticize the financial inability defense because it could create incentives for fiduciary disloyalty,[223] such concerns are likely misplaced. In most cases, fiduciaries are not inclined to want their businesses to fail, much as attorneys do not want their firms to fail.[224] A fiduciary would be out of a job and would be saddled with a potentially profitable, but uncertain, corporate opportunity.

Moreover, not permitting a limited financial inability defense would raise the same economic innovation and allocative efficiency concerns described above.[225] A business—always optimistic about recovering financially even in the face of severe financial distress—may be inclined to store away the opportunity until such time it is able to exploit the opportunity.[226]

> mine on his own that the corporation is financially unable to exploit the opportunity and to develop the opportunity without tendering it to the corporation.

Id.

223. *See supra* text accompanying notes 155-64.

224. *See* Begert, *supra* note 145, at 859. Begert observes:

> The rejection [of incapacity defenses] presumably represents a reaction to the problem of participants withholding their best efforts in order to create the false appearance of corporate inability. But such a reaction is based on the questionable premise that participants will be willing to run their corporations into the ground in order to create inability. The threat of a direct suit for failure to use best efforts should adequately deter such conduct.

225. Although not directly on point, Richard Booth's discussion of the costs and benefits of diluting or waiving fiduciary duties is instructive:

> Although fiduciary duty may sound at first like one of those things of which more is always better, it is not. Fiduciary duty can easily be used by opportunistic partners to unduly confine the side activities of other partners. The casebooks are replete with cases in which principals have sought to prevent their agents from taking advantage of opportunities in which the principal had no genuine expectation, and cases in which principals have sought to prevent their agents or former agents from competing, sometimes only after waiting to see whether or not the competitive venture was successful.

Booth, *supra* note 29, at 59.

226. *Cf.* Davis, *supra* note 19, at 237. Professor Davis criticizes this rationale for a financial inability defense when applied to an opportunity that is within a business's interest and expectancy. He writes that the financial inability "qualification ignores whatever development efforts the corporation undertook to reach the interest or expectancy threshold. Even though the corporation is financially incapable of taking advantage of the opportunity, the better rule would be to assure it some compensation for those successful development efforts by prohibiting others from taking advantage of the opportunity without the corporation's consent." *Id.* Professor Davis has a point, although the applicability of his argument is misplaced. The financial inability defense contemplated by the proposed statute

Therefore, the same allocative efficiency concerns encountered with the strict disclosure tests and the consent by non-activity defense are present if a limited financial inability defense is not permitted.[227]

Permitting a limited financial inability defense also is consistent with a hypothetical contract analysis. If the parties would have contemplated severe financial distress (how many parties would do this at the outset?) they would likely come to the conclusion that if a fiduciary is unable to rectify the business's financial problems through reasonable diligence, he should be permitted to take the opportunity personally.

3. *After the Fact Ratification*

Although no cases have been found accepting after the fact ratification by a decisionmaking body as a defense to a corporate opportunity claim, the defense is accepted by the proposed statute.[228] After the fact ratification by a disinterested decisionmaking body is permitted as a defense because, although it may not necessarily promote allocative efficiency, it is consistent with a contractual theory of the duty of loyalty.

After the fact ratification of a fiduciary's usurpation of a corporate opportunity is no different from an *ex ante* agreement by the parties permitting the fiduciary to take a certain class of corporate opportunities. Perhaps a business will ratify a fiduciary's taking to compensate her; more likely, however, the business will recognize that it could not have profitably exploited the opportunity. In any event, the propriety of the decision would be subject to the business judgment rule. Some commentators will likely criticize after the fact ratification because rati-

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would not apply in circumstances where the business has already invested resources in developing an opportunity; it would only apply to those circumstances where the business had no or a negligible role in the development of the opportunity.

227. *See* Orlinsky, *supra* note 44, at 461-62. Orlinsky, however, goes on to require that the fiduciary present the opportunity to the decisionmaking body for acceptance or rejection. *Id.* at 462. Although this may be good legal advice for a risk-adverse fiduciary, it should not be required under the corporate opportunity doctrine.

228. *See* Canion v. Tex. Cycle Supply, Inc., 537 S.W.2d 510, 514 (Tex. Civ. App. 1976).

fication is only subject to the business judgment rule.[229] Their argument, then, should be directed at the relative leniency of the business judgment rule in certain jurisdictions, including Delaware.

V. CONCLUSION

The statute proposed in this Article attempts to establish a coherent corporate opportunity analysis that fosters predictability and enforces a relatively strict view of the fiduciary duty of loyalty. The statute, however, also attempts to foster allocative efficiency and encourage economic innovation. Consistent with a hypothetical contract analysis of the duty of loyalty, the statute essentially retains the traditional tests for establishing the existence of a corporate opportunity. But, the statute does not require a fiduciary to disclose all corporate opportunities to his business; although he may decide to do so to protect against future litigation. Rather, the statute permits a fiduciary three limited defenses that must be established by clear and convincing evidence. The statute recognizes that the rejection of strict disclosure and the acceptance of limited fiduciary defenses will promote innovation and allocative efficiency, by not permitting businesses to store away opportunities for later, uncertain exploitation. Finally, the statute unequivocally rejects the fairness test/defense that plagues fiduciaries, businesses, and courts alike. By rejecting any fairness inquiry, the statute recognizes that in a relatively ordered business atmosphere, such tests create uncertainty, with no significant offsetting benefits.

229. *Cf.* Brudney & Clark, *supra* note 42, at 1035-36. In the contemporaneous-consent context, Brudney and Clark argue that even after disinterested stockholder or director approval, "the 'business judgment' defense should not be permitted to shield the arrangement from meaningful judicial scrutiny." *Id.*