# Delaware Journal of Corporate Law

VOLUME 2 1977 NUMBER 1

## THE CORPORATE OPPORTUNITY DOCTRINE IN DELAWARE: A GUIDE TO CORPORATE PLANNING AND ANTICIPATORY DEFENSIVE MEASURES

By DAVID CLAYTON CARRAD*

THE CORPORATE OPPORTUNITY DOCTRINE generally forbids a person who stands in a fiduciary relationship to a corporation to take for himself a business opportunity to which the corporation is equitably entitled. The doctrine is a specific application of the general rule that directors, officers and controlling stockholders[1] have both affirmative and negative fiduciary obligations, analogous to those of trustees, to the stockholders who have invested their funds in the corporation, entrusting discretionary authority over those funds to the corporate managers. The doctrine is a creation of the courts rather than legislative enactment and has developed in Delaware along the general lines found in the decisions of other States without specific reference to the Delaware General Corporation Law.[2]

It is difficult to extract from the leading cases in Delaware (or other jurisdictions) specific guidelines which an attorney advising a

* David Clayton Carrad graduated from Trinity College (Hartford, Connecticut) in 1965 and from the Harvard Law School in 1972. He is a member of the Delaware and New York bars and conducts his own law practice in Wilmington, Delaware.

1. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); 3 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 861.1, at 227 (perm. ed.). As to the fiduciary duty of controlling stockholders, *see* Harriman v. E.I. duPont de Nemours & Co., 372 F. Supp. 101, 105–06 (D. Del. 1974); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719–20 (Del. 1971); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 434–35 (Del. Ch. 1968); Allied Chem. & Dye Corp. v. Steel Tube Co. of America, 120 A. 486, 491–92 (Del. Ch. 1923) and n.16 *infra*. *Cf.* 8 DEL. C. § 141(a) (1974) ("The business and affairs of every corporation . . . shall be managed by a board of directors, *except as may be otherwise provided . . . in its certificate of incorporation*") (emphasis added).

2. *See*, however, the discussion of 8 DEL. C. § 144 (1974) in Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976), *aff'g* Civil Action No. 3647, 1 DEL. J. CORP. L. 145 (Del. Ch. 1974) and text accompanying nn.127–31 *infra*.

corporate director, officer or controlling stockholder may apply with certainly to determine which transactions may invoke the application of the doctrine or whether a recognized exception or defense is available. The courts have frequently but not very helpfully, stated their decisions on corporate opportunity claims depend in large measure on the particular facts and circumstances of each case.[3] The purpose of this article is to delineate as sharply as possible the elements and outer boundaries of the doctrine in Delaware, to set forth the currently recognized defenses to claims asserted under it and to suggest anticipatory defensive measures by which persons subject to the doctrine may prudently conduct their affairs while standing in a fiduciary relationship to a Delaware corporation.

The last portion of this article suggests that the corporate opportunity doctrine has been developed by the courts to a point beyond that required to protect the interests of corporate stockholders and is inconsistent with adequate fiduciary standards and contemporary commercial realities. Several of the author's recommendations suggest that the doctrine can and should be contractually modified under certain circumstances. There are certain present-day critics of Delaware's corporation law who, with only a cursory glance at the author's proposals, will attack them as merely another method for corporate management to feed buckshot to the stockholders' frog. While this article is written from the point of view of counsel for potential defendant, such critics are referred to the words of Mr. Justice Frankfurter in *SEC v. Chenery Corp.* in whose spirit this article was written:

> We reject a lax view of fiduciary obligations and insist upon their scrupulous observance. But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry.[4]

### A. THE ELEMENTS OF THE CORPORATE OPPORTUNITY DOCTRINE IN DELAWARE.

The elements of the corporate opportunity doctrine are easy to state in general terms but not easy to apply to particular factual situations. The initial statement of the doctrine in Delaware is found in the leading Delaware Supreme Court case of *Guth v. Loft, Inc.*[5] which was succinctly summarized in *Equity Corp. v. Milton*[6]:

> The rule of the *Guth* case is that when there is presented to a corporate officer a business opportunity which the corporation

3. Johnston v. Greene, 121 A.2d 919, 823, 924 (Del. 1956); Guth v. Loft, Inc., 5 A.2d 503, 511, 513, 514 (Del. 1939); Gottlieb v. McKee, 107 A.2d 240, 243-44 (Del. Ch. 1954).
4. 318 U.S. 80, 85-86 (1943) (citations omitted).
5. 5 A.2d 503 (Del. 1939) [hereinafter cited as *Guth*].
6. 221 A.2d 494 (Del. 1966).

> is financially able to undertake, and which, by its nature, falls into the line of the corporation's business and is of practical advantage to it, or is an opportunity in which the corporation has an actual or expectant interest, the officer is prohibited from permitting his self-interest to be brought into conflict with the corporation's interest and may not take the opportunity for himself.
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> A corollary of the *Guth* rule is that when a business opportunity comes to a corporate officer, which, because of the nature of the opportunity, is not one which is essential or desirable for his corporation to embrace, being an opportunity in which it has no actual or expectant interest, the officer is entitled to treat the business opportunity as his own and the corporation has no interest in it provided the officer has not wrongfully embarked the corporation's resources in order to acquire the business opportunity.[7]

Another major aspect of the doctrine was set forth in *Kaplan v. Fenton*[8]:

> By reason of the *Guth* case, if a business opportunity comes to a corporate director in his individual capacity, and if the opportunity is not essential to his corporation and in which his corporation has no interest, and if the corporate resources have not been wrongly embarked therein, the corporate director is free to treat the opportunity as his own.[9]

The underlying purpose of the corporate opportunity doctrine as perceived by the Delaware courts was perhaps best expressed in the *Guth* decision itself:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied,

7. *Id.* at 497.
8. 278 A.2d 834 (Del. 1971).
9. *Id.* at 836.

> and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.
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> If an officer or director of a corporation, in violation of his duty as such, acquires gain or advantage for himself, the law charges the interest so acquired with a trust for the benefit of the corporation, at its election, while it denies to the betrayer all benefit and profit. The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation. Given the relation between the parties, a certain result follows; and a constructive trust is the remedial device through which precedence of self is compelled to give way to the stern demands of loyalty.
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> 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.[10]

The remedy for a violation of the doctrine is the harsh[11] — but appropriate — imposition of a constructive trust for the benefit of the corporation on all the fruits of the misappropriated opportunity.[12] The Delaware decisions adhere, in the principles set forth above, to the majority rule in the United States,[13] steering a middle ground between Georgia, which does not recognize the doctrine at all,[14] and Massachusetts, which has seemingly disregarded all specific guidelines in favor of the broader " 'application of ethical standards of what is

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10. 5 A.2d at 510.

11. "The imposition of a constructive trust sometimes permits the corporation to recover, in addition to separate damages for any injury suffered, all profits earned by the defendant even if they are traceable solely to his initiative and skill and even though the risk of loss lay entirely on him." Note, *Corporate Opportunity*, 74 HARV. L. REV. 765, 766 (1961); *see also* Bailey v. Jacobs, 325 Pa. 182, 189 A. 320, 324 (1937) ("It is immaterial that [defendant's] dealings may not have caused a loss or been harmful to a corporation; the test of liability is whether [defendants] have unjustly gained enrichment."). *Cf.* RESTATEMENT (SECOND) OF AGENCY §§ 403, 404.

12. Lincoln Stores, Inc. v. Grant, 309 Mass. 417, 34 N.E.2d 704 (1941). *Compare* Maclary v. Pleasant Hills, Inc., 109 A.2d 830, 836–37 (Del. Ch. 1954) (constructive trust for corporate opportunity doctrine violation) *with* Craig v. Graphic Arts Studio, Inc., 166 A.2d 444, 446 (Del. Ch. 1960) (measure of damages for breach of fiduciary duty be competing with corporation is "what injury, if any, resulted to Graphic by virtue of [Craig's competition]") (both opinions by Chancellor Seitz).

13. *See generally* 3 FLETCHER, CYCLOPEDIA OF CORPORATIONS §§ 861–65 (perm. ed.); 19 AM. JUR. (SECOND) *Corporations* §§ 1310–14; Note, *Corporate Opportunity*, 74 HARV. L. REV. 765 (1961) and sources cited therein.

14. Gaynor v. Buckley, 203 F. Supp. 620, 626–27 (D. Ore. 1962) (applying Georgia law); Regenstein v. Regenstein Co., 213 Ga. 157, 97 S.E.2d 693 (1957); *Cf.* 22 GA. C. §§ 710–11 (1969).

fair and equitable'."[15] The key elements of the corporate opportunity doctrine in Delaware are discussed in the following order:

1. To whom is the opportunity offered?
2. The "present interest or expectancy" test.
3. The "line of business" test.
4. The "essential" test.
5. The use of corporate resources.

1. *To whom is the opportunity offered?* The Delaware cases treat differently business opportunities offered to a corporate manager[16] in his official capacity, *i.e.*, as an agent of the corporation, and those offered to him as an individual. In the former case the opportunity belongs to the corporation if it is "from its nature, in the line of the corporation's business and is of practical advantage to it. . . ."[17] If, on the other hand, the opportunity is offered to the corporate manager as an individual (or as a corporate manager of another enterprise), the Delaware courts have applied a different standard to determine whether or not the opportunity belongs in equity to the corporation. The opportunity must be "essential" to the corpora-

15. Durfee v. Durfee & Canning, Inc., 323 Mass. 157, 80 N.E.2d 522, 529 (1948) (citation omitted).

16. This term is used throughout the rest of this article to denote an officer, director or controlling stockholder whose status in the corporation subjects him to a fiduciary duty with respect to corporate opportunities, *supra* note 1. Stockholders are subject to this fiduciary duty only if they exercise actual control over the affairs of the corporation. "When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation. Unless the majority in such case are to be regarded as owing a duty to the minority such as is owed by the directors to all, then the minority are in a situation that exposes them to the grossest frauds and subjects them to most outrageous wrongs." Allied Chem. & Dye Corp. v. Steel Tube Co. of America, 120 A. 486, 491 (Del. Ch. 1923); Harriman v. E.I. duPont de Nemours & Co., 372 F. Supp. 101, 105-06 (D. Del. 1974); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 434-35 (Del. Ch. 1968). It has been suggested that a director's or officer's fiduciary duty may be diminished if (with the corporation's assent) he devotes only part of his time to its business and affairs. Bates v. Dresser, 251 U.S. 524, 528-31 (1920) (Holmes, J.); Burg v. Horn, 380 F.2d 897, 900 (2d Cir. 1967); 3 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 991 (perm. ed.); Note, *Corporate Opportunity*, 74 HARV. L. REV. 765, 769 (1961). *Cf.* RESTATEMENT (SECOND) OF AGENCY § 404.

17. Guth, 5 A.2d at 511. *Cf.* RESTATEMENT (SECOND) OF AGENCY § 388.

tion or one in which it has an interest or expectancy rather than one merely in its line of business.[18]

The meaning and application of the terms "interest," "expectancy," "essential" and "line of business" are discussed below, but the threshold question of the capacity in which the corporate manager was offered the opportunity must be answered before the proper criterion is applied.

The question is not typically an easy one to answer, since human affairs are not tidily conducted in functional compartments. What, for example, are we to make of the offer of the corporate opportunity in the leading case of *Johnston v. Greene*?[19] Defendant Odlum was the president of Airfleets, the derivative plaintiff. Odlum was also the president of Atlas, an investment company which owned 18% of Airfleets' stock, and he personally owned 11% of Atlas' stock. He was a man of "varied business interests," serving at the time of the disputed offer as chairman of the board of directors of Convair, a director of United Fruit Company and Wasatch Corporation and a trustee of several foundations.[20] The offer of the corporate opportunity was made to Odlum on behalf of one Hutson through Hutson's business acquaintance, Cousins. Hutson told Cousins that he wanted to sell certain stock and patents related to self-locking nuts used in the aircraft industry. "Cousins suggested that he (Cousins) talk to Mr. Odlum about it. Hutson assented. Hutson knew of Odlum by reputation as a well-known financier and president of Atlas Corporation, and as a man engaged in various enterprises. Hutson had never heard of Airfleets. Cousins was a friend of Odlum's . . . and was to spend New Year's weekend with Odlum at the latter's ranch in California. He also knew of Odlum's association with Convair and Atlas, but had never heard of Airfleets. On the Friday before New Year's Cousins broached the subject . . . Odlum was interested, and a few days later Hutson came to the ranch. . . ."[21] While the Delaware Supreme Court ultimately found that the opportunity had been offered

18. Kaplan v. Fenton, 278 A.2d 834, 836 (Del. 1971); Equity Corp. v. Milton, 221 A.2d at 497; Johnston v. Greene, 121 A.2d 919, 924 (Del. 1956); Guth, 5 A.2d at 510, 513; Fliegler v. Lawrence, Civil Action No. 3647, 1 DEL. J. CORP. L. 145, 152-53 (Del. Ch. 1974), *aff'd*, 361 A.2d 218 (Del. 1976); Gottlieb v. McKee, 107 A.2d 240, 243 (Del. Ch. 1954).

19. 121 A.2d 919 (Del. 1956).

20. *Id.* at 920.

21. *Id.* at 921.

to Odlum as an individual and not as Airfleets' agent,[22] its opinion raises far more questions than it answers:

> If it was [Odlum's] fiduciary duty, upon being offered any investment opportunity, to submit it to a corporation of which he was a director, the question arises, Which corporation? Why Airfleets instead of Atlas? Why Airfleets instead of one of the foundations? . . . Odlum testified that many of his companies had money to invest, and this appears entirely reasonable. How, then, can it be said that Odlum was under any obligation to offer the opportunity to one particular corporation? And if he was not under such an obligation, why could he not keep it for himself?
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> Plaintiff suggests that if Odlum elects to assume fiduciary relationship to competing corporations he must assume the obligations that are entailed by such relationships. So he must, but what are the obligations? . . . There is nothing inherently wrong in a man of large business and financial interests serving as a director of two or more investment companies, and both Airfleets and Atlas (to mention only two companies) must reasonably have expected that Odlum would be free either to offer to any of his companies any business opportunity that came to him personally, or to retain it for himself — provided always that there was no tie between any of such companies and the new venture or any specific duty resting upon him with respect to it. 3 FLETCHER, CYCLOPEDIA CORPORATIONS § 862.
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> . . . He chose to [offer the opportunity to Airfleets], although he could probably have sold the stock to an outside company at a profit to himself. If he had done so, who could have complained? If a stockholder of Airfleets could have done so, why not a stockholder of Atlas as well?[23]

While the opinion in *Johnston v. Greene* seems to focus on Odlum's diverse roles, it also suggests that the subjective intents of Hutson, the offeror, and Cousins, his agent, were important, if not determinative. In the Court of Chancery's opinion, Chancellor Seitz had stated: "[The] rule of fiduciary conduct to be adopted should tend to encourage action on behalf of the corporation. To give conclusive legal effect to the origin of the original approach would have a contrary tendency," even though he found that neither Hutson nor Cousins knew of Airfleets when the offer was made.[24] The Supreme Court

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22. *Id.* at 923, 925.

23. *Id.* at 924-25.

24. Greene v. Allen, 114 A.2d 916, 919-20 (Del. Ch. 1955), *rev'd sub. nom.* Johnston v. Greene, 121 A.2d 919 (Del. 1956). Although Chancellor Seitz found that the opportunity had come to Odlum in his "individual" capacity, he stated:

> [T]he opportunity was one in which Airfleets had an "interest" in the sense that through Odlum it was actively seeking valuable investments . . . [a]t the very

reversed, stating "such a sweeping extension of the rule of corporate opportunity finds no support in the decisions and is, we think, unsound."[25] A careful reading of the Supreme Court's ruling on this point indicates that the intent of the offeror is determinative, but this position is seemingly contrary to the ruling on the point in the *Guth* case in both the Court of Chancery[26] and the Supreme Court[27] concerning the intent of an offeror with the euphonious name of Megargel. Megargel died before his own testimony as to his intent could be taken. Each Court held Megargel's intent irrelevant on the alternative grounds that the opportunity to acquire Pepsi-Cola was either "essential" to Loft, Inc. or one in which it had an "interest or expectancy" because Guth was, at the time the offer was made, actively engaged in exploring the possibility of an association with Pepsi-Cola on Loft's behalf.[28] The two *Guth* decisions may be reconciled with the Supreme Court's decision in *Johnston v. Greene* if the rule is stated to be that the intent of the offeror governs unless the corporation already has, at the time the offer is made, an interest or expectancy in it, or if the offeree has already been dispatched by the corporation to seek similar opportunities on its behalf. In any event, the burden of proof as to the offeror's intent always rests on the corporate manager.[29]

2. *The "present interest or expectancy" test.* There are few cases in Delaware dealing directly with this aspect of the corporate opportunity doctrine. It is, however, one aspect of the decision in the *Guth* case[30] and has been mentioned briefly in the cases discussed below.

Perhaps the clearest delineation of the difference between a "present interest" and an "expectancy" is found in the Alabama case of *Lagarde v. Anniston Lime & Stone Co.*[31] in which the defendants purchased two one-third interests in a limestone quarry after becoming directors and majority stockholders of a corporation which already owned the remaining one-third interest. The corporation had, at the

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time this transaction was presented to him, Odlum was under an obligation to find such opportunities for Airfleets.

114 A.2d at 919.

25. 121 A.2d at 924.

26. 2 A.2d 225, 231, 239–41 (Del. Ch. 1938).

27. 5 A.2d at 512.

28. 2 A.2d at 229–30; 5 A.2d at 513.

29. 5 A.2d at 512. If the offeror is indifferent as to whether the corporation or the individual takes the opportunity, the *Guth* case suggests that all doubts should be resolved in favor of the corporation. *Id.* at 513.

30. *See* text accompanying note 28 *supra.*

31. 126 Ala. 496, 28 So. 199 (1900).

time of defendants' purchases, contracted to purchase one of defendants' one-third interests and had negotiated for the purchase of the other. The Alabama Supreme Court impressed a constructive trust on the one-third interest which the corporation had contracted to purchase but found no breach of fiduciary duty in the purchase of the interest for which it had merely negotiated.[32] The interest subject to the purchase contract clearly represents a "present interest" and the other interest an "expectancy." Another example of an expectancy is found in cases from other jurisdictions in which corporate managers obtained for their own benefit leases of property to commence at the end of their corporation's present lease terms, even though the corporation had no contractual right to renew its lease.[33]

In the Delaware case of *Dolese Bros. Co. v. Brown*[34] the stockholders of a closely-held family corporation entered into an agreement in 1942 that they would not sell their stock to outsiders without first offering it to the other stockholders and the corporation. In 1946 defendant Roger Dolese falsely told certain of his fellow stockholders that the corporation did not have sufficient funds to purchase the 40% of its stock which another group of its stockholders had offered to sell to it. Based on this misinformation, the directors and stockholders approved resolutions waiving the corporation's right to acquire the 40% stock interest which Roger Dolese then purchased for his own account.[35] The Delaware Supreme Court held: "[I]n the case before us the 1942 agreement gave the corporation some sort of expectancy in the purchase of the stock. *Guth v. Loft,* 23 Del. Ch. 255, 5 A.2d 503. The exact scope of the expectancy is not important; it is enough to say that Roger recognized its existence and undertook . . . to waive the corporate rights for his own benefit."[36] Similarly, in *Maclary v. Pleasant Hills, Inc.,*[37] the corporation sold to its corporate manager several vacant lots in a housing development which the corporation was developing itself. The corporate manager built houses on several of the lots and sold them at a profit. Chancellor Seitz's comment on the loss of the expectancy of the corporation in the right to develop these lots was: "in view of the fairly healthy financial condition of the corporate defendant at the time and the fact that the corporation was engaged in the business of erecting and renting and selling real

32. The latter result would have been different in Delaware. *See* text accompanying notes 33–38 *infra.*

33. *E.g.,* H.C. Girard Co. v. Lamoureux, 227 Mass. 277, 116 N.E. 572 (1917); Pikes Peak Co. v. Pfunter, 158 Mich. 412, 123 N.W. 19 (1909).

34. 157 A.2d 784 (Del. 1960).

35. *Id.* at 786.

36. *Id.* at 787.

37. 109 A.2d 830 (Del. Ch. 1954).

estate, I am forced to the conclusion that this was the type of opportunity which [the corporate manager] was under a duty to exercise for the benefit of the corporation."[38] Such an intimate connection with the corporation's present ownership rights or its activities in a specific area, though perhaps not yet rising to the status of enforceable contract rights, should not be hard to recognize in practice as an "expectancy."

3. *The "line of business" test.* A corporation may equitably lay claim to a business opportunity even though it can demonstrate no present interest or expectancy in it if the opportunity is in the corporation's "line of business" and is offered to a corporate manager acting as such. Whether a particular corporate opportunity is in the line of business of a corporation is essentially a question of fact. The Delaware Supreme Court's definition in the *Guth* case is again the starting point for analysis:

> The phrase 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. 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 having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business.[39]

One basis for the decision in the *Guth* case was that an opportunity to acquire Pepsi-Cola, a manufacturer and wholesaler of cola syrup, was in the line of business of Loft, Inc., a cola beverage retailer which manufactured other types of syrup and required a source of supply of cola syrup for its retail operations.[40]

In *Equity Corp. v. Milton,*[41] the Delaware Supreme Court held that the acquisition of its own shares was not in a corporation's line of business since "plaintiffs have wholly failed to establish that there has ever been a corporate policy for Equity to acquire a large block of its own shares" despite the fact that the corporation clearly had

38. *Id.* at 836–37.

39. 5 A.2d at 511, 513, 514; Johnston v. Greene, 121 A.2d at 923, 924; Gottlieb v. McKee, 107 A.2d 240, 243–44 (Del. Ch. 1954).

40. *But see* text accompanying notes 53–55 *infra.*

41. 221 A.2d 494 (Del. 1966).

the power to do so.[42] Without any elaboration on the facts or legal principles involved, the Court of Chancery held in *Fliegler v. Lawrence*,[43] that antimony mining claims in Sanders County, Montana, were in the line of business of a corporation organized to develop gold and silver mining claims in Custer County, Idaho,[44] and in *David J. Greene & Co. v. Dunhill Int'l, Inc.*,[45] that the opportunity to acquire a corporation which manufactured and distributed educational toys and visual aid teaching devices was in the line of business of a corporation (Spalding) which manufactured athletic equipment and "Tinkertoys."[46] In *Johnston v. Greene*,[47] the Delaware Supreme Court held that Airfleets, which had substantial funds to invest and was actively seeking investments but which had never engaged in any business of any kind, had no line of business at all. "It is one thing to say that a corporation with funds to invest has a general interest in investing those funds; it is quite another to say that such a corporation has a specific interest attaching in equity to any and every business opportunity that may come to any one of its directors. . . ."[48]

If any guideline more specific than the language quoted above from the *Guth* case[49] can be established, it may be that an opportunity is within a corporation's line of business if it has developed certain tangible or intangible assets — a system of distributors on the wholesale or retail level, capital goods, marketing or advertising skills in a particular field or a specialized staff — which would enable it to exploit the opportunity with an unusual degree of efficiency or profitability. Note that the line of business in which the opportunity is found need not be identical to the line of business of the corporation, but merely sufficiently analogous to permit the transition to the corporation's ownership to be markedly smooth and economical.[50]

4. *The "essential" test.* As noted above, a corporate opportunity brought to a corporate manager as an individual, perhaps by an offeror who does not even know of the corporation or the corporate manager's

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42. *Id.* at 497.
43. Civil Action No. 3647, 1 DEL. J. CORP. L. 145 (Del. Ch. 1974), *aff'd*, 361 A.2d 218 (Del. 1976).
44. *Id.* at 153.
45. 249 A.2d 427 (Del. Ch. 1968).
46. *Id.* at 435.
47. 121 A.2d 919 (Del. 1959).
48. *Id.* at 924. *Accord*, Equity Corp. v. Milton, 221 A.2d at 497–98 (opportunity to purchase its own stock not in corporation's line of business since it had never done so and had no plans to do so despite its clear power to make such purchases).
49. *See* text accompanying note 39 *supra*.
50. *See* Chapman v. Fluorodynamics, Inc., Civil Action No. 2619, Letter Opinion, March 19, 1970 (Del. Ch.) (expansion of market for company's product into new industry and new geographic area). *Cf.* Guth, 5 A.2d at 513–14.

connection with it,[51] may still belong to the corporation if it is "essential" to it. While the word "essential" has been frequently used in opinions on the corporate opportunity doctrine in Delaware[52] it has not — with one possible exception — served as the *ratio decidendi.* The possible exception is the *Guth* case, although the language of the Supreme Court's opinion indicates that its decision can also be supported on the ground that Loft had an expectancy in the opportunity,[53] that the opportunity was in Loft's line of business and offered to Guth in his capacity as a corporate manager,[54] that Guth used Loft's assets in acquiring the opportunity for himself[55] or even that Guth was competing with Loft.[56]

Loft was a Delaware corporation engaged in manufacturing and selling candy, syrups, beverages and food, primarily as a retailer although wholesaling was an important part of its business. In 1931 it operated 115 stores along the Middle Atlantic seaboard. It manufactured its own syrup for its retail fountain needs with the sole exception of the syrup for "cola" drinks which it purchased from Coca-Cola at a rate of 30,000 gallons per year. Guth, as Loft's president, decided in 1931 that his company was paying too much for Coca-Cola syrup and suggested in May of that year that Loft explore the possibility of purchasing cola syrup from Pepsi-Cola.

Pepsi-Cola simultaneously filed for bankruptcy. At that time Pepsi-Cola had been in business for approximately 25 years, chiefly in the South, and had a secret formula and trademark for its cola syrup. Megargel, Pepsi-Cola's corporate manager, approached Guth and offered to sell the secret formula and trademark at an extremely attractive price.[57] On these facts the Supreme Court concluded:

> Loft had a practical and *essential* concern with respect to some cola syrup with an established formula and trademark. A cola beverage has come to be a business *necessity* for soft drink establishments; and it was *essential* to the success of Loft to serve at its soda fountains an acceptable five cent cola drink in order to attract into its stores the great multitude of people who have formed the habit of drinking cola beverages. When Guth determined to discontinue the sale of Coca-Cola in the Loft stores, it became, by his own act, a matter of *urgent necessity* for Loft to acquire a constant supply of some satisfactory cola syrup, secure against probable attack, as a replacement; and when the Pepsi-Cola

51. *See* Johnston v. Greene, 121 A.2d at 921.
52. *See* note 18 *supra.*
53. 5 A.2d at 512, 513–14.
54. *Id.* at 507.
55. *See* text accompanying notes 62–64 *infra.*
56. 5 A.2d at 513, 515.
57. *Id.* at 505–06.

> opportunity presented itself, Guth having already considered the availability of the syrup, it became impressed with a Loft interest and expectancy arising out of the circumstances and the *urgent and practical need* created by him as the directing head of Loft.[58]

Note, however, that even within the short passage quoted above the Supreme Court refers to an "expectancy" as well as the "essential" nature of the opportunity and, as noted above, the decision is bottomed on several alternative grounds.[59] The Pepsi-Cola opportunity was almost certainly not essential to the survival or modest prosperity of Loft since it seems to have been in a healthy financial condition at the time and had other operating businesses generating substantial revenues.[60]

A suggested reading of the term "essential" in the corporate opportunity context is that when a corporation loses or is threatened with the imminent loss of a major supplier or customer, particularly in a sector of the economy which contains few competitors, the chance to replace the departing supplier or customer is an essential opportunity even though the corporation might limp along or even operate profitably without a replacement.[61] Under this interpretation an essential opportunity is to be distinguished from one merely in the corporation's line of business. If an essential opportunity is snatched away from the corporation it will suffer a loss of revenues; denial of an opportunity in its line of business merely denies it a chance to increase its present earnings. Both kinds of usurpation are forbidden by the corporate opportunity doctrine, but the prohibition in the case of an essential opportunity extends even to cases in which the offer is directed to the corporate manager in his individual capacity.

5. *The use of corporate resources.* Even if an opportunity properly may be taken by a corporate manager for his own account under the guidelines discussed above, the Delaware courts have frequently stated that this liberty is subject to the qualification that he "has not wrongfully embarked the corporation's resources in order to acquire the business opportunity."[62] This factor was undeniably present in

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58. *Id.* at 514 (emphasis added).

59. *See* notes 53–55 *supra.*

60. 5 A.2d at 505–06.

61. In this area the corporate opportunity doctrine begins to approach the separate, but related, case dealing with corporate managers who enter into direct competition with their corporations. *See* Craig v. Graphic Arts Studio, Inc., 166 A.2d 444 (Del. Ch. 1960).

62. Equity Corp. v. Milton, 224 A.2d at 497; Fliegler v. Lawrence, Civil Action No. 3647, 1 Del. J. Corp. L. at 153, *aff'd,* 361 A.2d 218 (Del. 1976); Kaplan v. Fenton, 278 A.2d at 836; Guth, 5 A.2d at 510–11. *But see* Burg v. Horn, 380 F.2d 897 (2d Cir. 1967) (New York's law; other stockholders found to have acquiesced in defend-

the gross circumstances of the *Guth* case. Guth financed Pepsi-Cola by an indirect infusion (through Grace, a corporation owned by Guth and his family) of Loft's own working capital which exceeded $100,000 within three years after his acquisition of Pepsi-Cola. He made extensive use of Loft's plants, facilities, materials, credit, senior executives, employees and a chemist, and even paid the Pepsi-Cola payroll directly from Loft's funds. He caused Loft to expend $20,000 on Pepsi-Cola advertising. At one point virtually all of Loft's working capital was invested in Pepsi-Cola without the knowledge of Loft's directors.[63]

> Guth took without limit or stint from a helpless corporation . . . He invested little or no money of his own in the venture, but commandeered for his own benefit and advantage the money, resources and facilities of his corporation and the services of its officials. He thrust upon Loft the hazard, while he reaped the benefit. His time was paid for by Loft . . . In such manner he acquired for himself . . . ninety-one percent of the capital stock of Pepsi, now worth many millions.[64]

A similar bootstrap operation was conducted by defendant Roger Dolese in *Dolese Bros. Co. v. Brown,*[65] who purchased from certain fellow stockholders for his own account a 40% stock interest in which their corporation itself had an expectancy.[66] He paid for the stock with the cash proceeds of a partial liquidating distribution with respect to the 40% stock interest and with a bank loan secured in part by a pledge of certain assets he acquired in the liquidating distribution.[67] "Roger, as a result of the various steps taken, has appropriated for himself the most valuable part of the corporate business by using corporate funds . . . The fact that his own [original] stock was also used to obtain credit is immaterial. The purchase of the [40% stock interest] could not have been made without corporate funds."[68]

The use of corporate assets in *Guth* and *Dolese* was clearly an abuse of the corporate manager's official position flagrant enough independently to support the courts' decisions that the opportunities rightfully belong to the corporation even if no other elements of the corporate opportunity doctrine had been present. Decisions on this point from

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ants' use of corporate funds). The *Burg* case is discussed again in the text accompanying notes 143–45 *infra.*

63. 5 A.2d at 506–07.

64. *Id.* at 515.

65. 157 A.2d 784 (Del. 1960).

66. *See* text accompanying notes 34–36 *supra.*

67. 157 A.2d at 786–87.

68. *Id.* at 787.

other jurisdictions generally reveal equally gross abuses.[69] The magnitude of the misappropriated corporate assets, relative to the amount required to take the opportunity or to the total corporate assets, in these cases suggests that the courts would not find a minor use of the corporation's assets, such as a telephone call or two made from its office at its expense, sufficient to invoke the harsh penalties of the corporate opportunity doctrine absent some other taint.[70] It is difficult to imagine a court imposing a constructive trust on the property of a defendant when the opportunity was offered to him in his individual capacity, was not one in which his corporation had an interest or expectancy, was not in its line of business and was not essential to it, if all the defendant did was to reproduce his acceptance letter on the corporate photocopier or run it through the corporate postage meter. In a close case — for example, one in which the intent of the offeror is ambiguous or undeterminable — even such a minor use of the corporation's assets might be considered circumstantial evidence of the capacity in which the corporate manager was acting in dealing with the opportunity. This is not an issue any potential defendant's attorney wants to litigate if it can be avoided, and the only prudent advice to give to his client is that he pursue any opportunity arguably within the scope of the corporate opportunity doctrine on his own time and entirely at his own expense.

### B. AFFIRMATIVE DEFENSES.

The defenses to corporate opportunity claims under Delaware law have, like the doctrine itself, been developed by the courts from common-law and general equitable principles rather than through

69. *See, e.g.,* Paulman v. Kritzer, 74 Ill. App. 284, 219 N.E.2d 541 (1966) (purporting to apply Delaware law); Samia v. Central Oil Co., 339 Mass. 101, 158 N.E.2d 469, 482 (1959) ("In exploiting this opportunity [defendants] used all of Central's resources without reserve"); Harry R. Defler Corp. v. Kleeman, 243 N.Y.S.2d 930, 934 (N.Y. App. Div. 1963) ("Defendants . . . vouched for Carchem's [a corporation defendants had formed to compete with plaintiff] credit in plaintiff's name and even charged telephone and travel expenses to plaintiff although they were incurred in the interests of Carchem. Their audacity probably reached its peak when they paid, with plaintiff's funds, the legal fees incurred in connection with the incorporation of Carchem. Their conduct was not only completely reprehensible, but completely astounding.").

70. Lincoln Stores, Inc. v. Grant, 309 Mass. 417, 34 N.E.2d 704 (1941) (no usurpation of corporate opportunity found when defendant employees charged travel expenses to corporation and used some of its confidential information; however, corporation had no desire to expand and was awarded damages for loss of profits caused by defendants' competition); Note, *Corporate Opportunity,* 74 HARV. L. REV. 765, 777-78 (1961). *But see* Weisman v. Snyder, 338 Mass. 502, 156 N.E.2d 21, 23 (1959) (use of time for which defendant received compensation from corporation and "minor corporate expense moneys"; opportunity offered to defendant "only because of [his] connection with the corporation.").

statutory enactment. The three defenses recognized in Delaware are the corporation's inability to make use of the opportunity, tender of the opportunity to the corporation and rejection by it, and ratification.

1. *Inability of the corporation to take the opportunity.* Several Delaware cases have indicated that a corporate manager has no obligation to offer a corporate opportunity to his corporation if it "is financially unable to avail itself of the opportunity at the time or if it is clearly undesirable for the corporation to attempt to undertake the opportunity because of other factors."[71] In *Fliegler v. Lawrence,*[72] the derivative plaintiff, Agau, had been formed in 1968 for the purpose of exploring and subsequently mining certain gold and silver claims in Custer County, Idaho. A public offering of its securities in 1969 raised approximately $110,000. The prospectus stated that the use of proceeds of the public offering would be limited to the first of several required stages of exploring the Custer County gold and silver claims. Late in 1969 after most of these proceeds had been spent, Lawrence, one of Agau's directors and employees, was offered, as an individual and not as a representative of Agau, an opportunity to purchase certain antimony claims in Sanders County, Montana, for $60,000 payable over a four-year period. The Court of Chancery held:

> [T]he antimony claims, at the time Lawrence acquired them, did fall within the category of a business opportunity which, all things being equal, would have belonged to Agau . . . . It is also obvious, however, that at that time Agau, because of its limited assets and the restrictions imposed on them by its public offering, was not in a financial position to commit itself to the speculative acquisition and development of a mining opportunity outside the scope of its registration statement . . . .
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> . . . I therefore conclude that when the raw antimony prospect presented itself to Lawrence, it was neither legally advisable nor financially feasible for Agau to attempt to take it, and as a consequence Lawrence was free . . . to retain it as his own . . . .[73]

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71. Fliegler v. Lawrence, Civil Action No. 3647, 1 Del. J. Corp. L. at 153, *aff'd,* 361 A.2d 218 (Del. 1976); Wolfensohn v. Madison Fund, Inc., 253 A.2d 72, 76 (Del. 1969); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 435 (Del. Ch. 1968); Equity Corp. v. Milton, 221 A.2d at 497; Guth, 5 A.2d at 511, 513.

72. Civil Action No. 3647, 1 Del. J. Corp. L. 145 (Del. Ch. 1974), *aff'd,* 361 A.2d 218 (Del. 1976).

73. *Id.* at 153–54. *See also* Barr v. Pittsburgh Plate-Glass Co., 51 F. 33 (W.D. Pa. 1892), *aff'd,* 57 F. 86 (3d Cir. 1893) (geographic limitation in certificate of incorporation); Urban J. Alexander Co. v. Trinkle, 311 Ky. 635, 224 S.W.2d 923 (1949) (corporate debt limitation in certificate of incorporation).

In *Wolfensohn v. Madison Fund, Inc.*,[74] Delaware's Supreme Court held that plaintiff's claim, which was based on an analogy to the corporate opportunity doctrine, could not be sustained when the corporation, a railroad, was not financially able to acquire any non-transportation enterprises for cash and was subject to an Interstate Commerce Commission prohibition against acquiring such businesses for credit or securities.[75]

While no Delaware cases have considered the issue of whether a corporation may be deprived of a corporate opportunity if it could borrow sufficient funds or otherwise finance a transaction which it has insufficient resources to effect itself, the Seventh Circuit held in *Santarelli v. Katz*[76] that under Illinois law a corporation's officers and directors had no obligation to pledge their personal credit to enable their corporation to finance the acquisition of an opportunity. In 1952 Elkay, the derivative plaintiff, needed new quarters for its expanding manufacturing operations. It proved impossible for Elkay to borrow the necessary funds because of its financial difficulties. The directors of Elkay formed a new corporation, Timmus, and pledged their personal credit to secure various loans which Timmus used to erect a factory. The factory was subsequently leased to Elkay, which was still unable to obtain the necessary financing to acquire its own quarters.[77] The Seventh Circuit commented:

> The contention of plaintiff comes to this — if four of the directors of Elkay were willing to pledge their personal credit to obtain financing for Timmus, a company which they, in effect, owned, they were bound to do the same thing for Elkay. . . . We agree with the District Court there was no breach of a fiduciary relationship when the directors on their own personal credit, obtained for the benefit of Elkay something that Elkay could not itself provide.[78]

While the contrary result was reached in *Irving Trust Co. v. Deutsch*,[79] in which the Second Circuit stated that it was applying Delaware law, that case may be distinguished from *Santarelli v. Katz* on the ground

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74. 253 A.2d 72 (Del. 1969).

75. *Id.* at 74, 75; 3 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 862.1 (perm. ed.). *Cf.* Lipkin v. Jacoby, 202 A.2d 572, 574 (Del. Ch. 1964) (no breach of fiduciary duty in sale to corporation of part interest in real estate acquired by directors when corporation "was not financially able to do so").

76. 270 F.2d 762 (7th Cir. 1959).

77. *Id.* at 766.

78. *Id.* at 767. *Cf.* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 888 (Del. 1970) ("Granted, the fact that the parent [corporation] owes a fiduciary duty to its subsidiary, the duty does not require self-sacrifice from the parent.").

79. 73 F.2d 121 (2d Cir. 1934), *cert. denied*, 294 U.S. 708 (1935).

that at the time the opportunity was offered to the corporation in the *Irving Trust Co.* case, defendant Deutsch personally owed the corporation more than enough for it to acquire the opportunity.[80] The *Irving Trust Co.* case should be read narrowly in the light of this fact despite the Second Circuit's apparent announcement of a different general rule under Delaware law.[81]

In any event short of complete insolvency, the actual financial inability of the corporation must be proved by the defendant. Thus it was not enough that Guth merely thought that the acquisition of Pepsi-Cola "would involve too great a financial risk" and that Loft, Inc. "was not equipped to carry on such business on an extensive scale;"[82] the Chancellor and the Supreme Court found " 'that Loft had the means to finance and establish the business is clearly demonstrated'."[83] Similarly, in *Maclary v. Pleasant Hills, Inc.*,[84] Chancellor Seitz rejected defendant's claims that at the time the opportunity was offered the corporation was "allegedly short of working capital"[85] and that defendant and his three sisters, who were also directors, "did not feel that the risk of additional construction should be undertaken by the corporation"[86] in finding that the development and resale of lots in a development owned by the corporation belonged to it and should not have been taken by defendant.[87]

The inability of the corporation to take the opportunity may arise from factors other than its financial condition. In *Fliegler v. Lawrence*[88] the Court of Chancery held that the antimony claims offered to Lawrence were a corporate opportunity to which plaintiff Agau was equitably entitled "all things being equal."[89] However, the Court of Chancery found for defendant Lawrence on this issue on the alternative grounds that plaintiff did not have and could not raise enough money to purchase the antimony claims, and, of equal importance, that those funds it did have could not legally be spent for purposes

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80. *Id.* at 124.

81. "If directors are permitted to justify their conduct on such a 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." *Id.* (citation omitted). This view has not been adopted in Delaware. *See* text accompanying note 70 *supra.*

82. 5 A.2d at 507.

83. *Id.* at 509, *quoting* Loft, Inc. v. Guth, 2 A.2d 225, 240 (Del. Ch. 1938).

84. 109 A.2d 830 (Del. Ch. 1954).

85. *Id.* at 837.

86. *Id.* at 836.

87. *Id.* at 836–37. Chancellor Seitz found that the corporation was in "fairly healthy financial condition," *id.* at 837.

88. Civil Action No. 3647, 1 Del. J. Corp. L. 145 (Del. Ch. 1974), *aff'd,* 361 A.2d 218 (Del. 1976).

89. *Id.* at 153.

other than those described in the prospectus for Agau's public offering — development of its gold and silver claims.[90] Similarly, in *Diedrick v. Helm*,[91] the Minnesota Supreme Court ruled that the plaintiff, a building and loan association, was barred both by statute and by its own by-laws from engaging in the insurance business.[92] It was therefore proper for the association's secretary to conduct a profitable sideline in insuring properties, most of which came to his attention because the association required properties subject to its mortgages to be insured.[93] And in *Thilco Timber Co. v. Sawyer*,[94] the Michigan Supreme Court sanctioned the purchase by a corporate director of a cotenant's interest in land partially owned by the corporation after its disinterested directors had concluded that the corporation could not legally make the purchase itself.[95]

Financial or legal inability of the corporation to take the opportunity is an affirmative defense. The burden of proof rests on the defendant and the issue will be resolved against him in a doubtful case.[96]

2. *Tender and rejection.* If counsel to a corporate manager determines that an opportunity offered to his client is, within the principles set forth above, one which should be offered to the corporation, the corporate manager may rightfully take it for his own if the corporation rejects it. The leading case in Delaware on this issue is *Kaplan v. Fenton*.[97] Christiana, the derivative plaintiff, owned all 40,000 shares of the Class A stock of Huntington but none of Huntington's 10,000 shares of Class B stock. In three years Christiana advanced over $5,000,000 to Huntington to develop unimproved land

90. *Id.* at 153–54. At the time the antimony claims were offered to him, Lawrence consulted an attorney who told him the officers and directors of Agau would be subject to criminal and civil penalties if Agau used funds raised by the public offering to acquire the antimony claim, but the attorney later questioned the applicability of his own advice to the facts. *Id.* at 149. Despite this confusion, this issue was clearly important to the Court of Chancery's conclusion, *id.* at 153–54, and the Supreme Court in affirming stated that Agau "was not in a position, either financially *or legally*, to accept the opportunity at that time . . . ." 361 A.2d at 220 (emphasis added).

91. 217 Minn. 483, 14 N.W.2d 913 (1944).

92. *Id.* at 917, 919–21. *Cf.* RESTATEMENT (SECOND) OF AGENCY §§ 411, 413.

93. *Id.* at 916.

94. 236 Mich. 401, 210 N.W. 204 (1926). This case, like the *Fliegler* and *Diedrick* cases discussed immediately above, seem to rest more on the good faith belief of the directors as to the illegality of the proposed transactions than on the actual illegality of the corporation's undertaking the opportunity. In this regard, see the discussion of tender and rejection *infra*.

95. However, the defense of illegality or certificate of incorporation or by-law restrictions is probably not available when a corporate manager uses the corporation's assets in the venture. Memphis & Arkansas City Packet Co. v. Agnew, 132 Tenn. 265, 177 S.W. 949 (1915).

96. Maclary v. Pleasant Hills, Inc., 109 A.2d at 837.

97. 278 A.2d 834 (Del. 1971).

Huntington owned near Los Angeles. None of the Class B stockholders advanced any funds to Huntington, but they benefited substantially from Christiana's underwriting of the development of Huntington's land. Christiana's directors determined to end this subsidy by purchasing the Class B stock and on January 28, 1963, received an offer of 2,200 Class B shares and 39,000 shares of Christiana's own stock for $500,000 in cash. Christiana's board rejected the offer on three grounds: (1) Christiana should acquire all or none of the 10,000 Class B shares, (2) Christiana's agreement with its bank forbade the purchase of its own shares and (3) Christiana was short of cash and should acquire Huntington's Class B stock only in exchange for its own stock. Approximately one month later defendant Fenton, a director of Christiana, received an offer of 2,240 Class B shares and some Christiana stock, again for cash. The offer was transmitted to Fenton through Banowit, a Christiana director and Class B stockholder. Fenton did not formally offer the opportunity to Christiana's board of directors, but he did relay the proposal to Christiana's president and chief executive officer and asked if he wanted the offer presented to the board. The answer was no. After further negotiations Fenton and certain other individuals purchased 1,540 Class B shares and Banowit 700 shares for $150 per share in cash.[98] The Delaware Supreme Court ruled:

> The facts of this case, as found by the Vice Chancellor and which are fully supported by the record, demonstrate that the offer to Fenton was not a corporate opportunity which he was duty-bound to pass on to Christiana. Initially, the Christiana board had unanimously rejected an almost identical offer only one month before. The objectionable features of this prior offer were the offer to sell for cash and the joining in of Christiana stock to be purchased. Both of these conditions were objectionable to the board. Secondly, the offer to sell was for only a fraction of the minority stock interest. This condition was objectionable to all the directors with the exception of Fenton. Thirdly, the offer to Fenton was for a fraction of the Class B stock for cash. This condition had been previously rejected by the board. Finally, Fenton asked the President of Christiana if he wanted him to submit the offer to the board and was answered "no."[99]

A case factually similar to *Kaplan v. Fenton* was decided under Delaware law by the United States District Court for the Eastern District of Missouri in *American Investment Co. v. Lichtenstein.*[100]

98. *Id.* at 835.
99. *Id.* at 836.
100. 134 F. Supp. 857 (E.D. Mo. 1955).

Plaintiff was a large corporation active in the consumer finance and personal loan fields. After a troublesome experience in purchasing the remaining minority stock interests in a 1950 acquisition of another consumer finance company (Domestic), plaintiff American in 1950 and 1951 instructed defendant Lichtenstein, its executive vice-president and a director, to break off negotiations for the acquisition of Liberty Loan Corporation under terms which would have left a strong minority interest in Liberty outstanding. Negotiations for the acquisition of Liberty by American were resumed in 1953 by Lichtenstein but broke off late in that year or early in 1954 on the issue of price. On February 1, 1954, Lichtenstein was granted a six-month leave of absence and four days later his duties as American's executive vice-president were transferred to others. The earlier offerors of the partial interest in Liberty learned of Lichtenstein's departure from American and began negotiations to sell him a substantial stock interest in Liberty if he would accept a management position with it. Lichtenstein promptly informed Barnes, a director and president of American, of the offer but was told "not to do anything for American." Within a few months Lichtenstein's position at American had been abolished and his connections with that company severed, evidently at Barnes' behest.[101] During this period Lichtenstein consummated his personal negotiations for a stock interest in Liberty, of which an integral part was an "Employees' Stock Purchase Plan."[102] American subsequently sued Lichtenstein for deprivation of a corporate opportunity to acquire Liberty's stock. The Court commented:

> While American desired to expand, as is typical of most businesses, the evidence disclosed that it was not its policy to purchase a minority interest without some formulated and effective plan to acquire substantially all, if not all, of the remaining outstanding assets or interests. Lichtenstein purchased a minority interest, and his plan or 'idea' of an Employees' Stock Purchase Plan went so far as to relinquish actual control over Liberty. Plaintiff alleges that it would have been ready, willing and able to embrace the Lichtenstein undertaking. However, what proof has it made of that allegation? None whatsoever.
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> The fact is that American stood still while others negotiated with . . . Liberty. Lichtenstein's plan or 'idea' was not a solution to the problem of 'dilution,' but rather, it only pointed to a solution, the solution being dependent upon the approval of the Liberty stockholders. The fair inference is that American did not want to purchase [Liberty's] stock on that basis any more in 1954 than it did in 1951, but rather, wanted a guarantee that its stock

101. *Id.* at 858–59.
102. *Id.* at 859–60.

would not be diluted by the purchase, before purchasing, which it could not get, and which Lichtenstein did not get.[103]

A similar result was reached in *Johnston v. Greene*,[104] although the Delaware Supreme Court went on to determine the basic fairness of the corporation's rejection of the opportunity since it found that Odlum, the corporate manager, dominated the rest of the board members.[105] Airfleets, the corporate plaintiff, decided to purchase the stock of the Nutt-Shel Company from Hutson after he had offered it to Odlum. Nutt-Shel manufactured self-locking nuts used in aircraft and Hutson personally owned several patents and patent applications covering these devices which were exclusively licensed to Nutt-Shel.[106] Odlum had been advised by Hutson and others, including several attorneys, that it was desirable to have separate entities own Nutt-Shel's stock and the patents "because of the possibility of the disallowance of royalty payments on renegotiation of government contracts."[107] Airfleet's directors decided that it should acquire only Nutt-Shel's stock for $1,000,000 both because the patents would require an additional investment of $350,000, which would make Airfleet's aggregate investment in this one enterprise equal to two-thirds of its net assets, and because of the supposed advantages of separate ownership of the patents. At a formal board of directors' meeting the vote was unanimously in favor of buying the stock but not the patents, which Odlum purchased for the benefit of himself, his wife and their friends and associates.[108] The Delaware Supreme Court upheld the directors' decision not to take the patents as one which would have commended itself to a wholly independent board of directors[109] and therefore held that Odlum was free to dispose of them as he saw fit after Airfleet's rejection.

*Kaplan* and *American Investment* demonstrate that an opportunity not materially different from one rejected by the corporation in the recent past may safely be taken by a corporate manager. If no such opportunity has previously been presented to the corporation, *Johnston v. Greene* permits the corporate manager to take the opportunity for his own if it is offered to and rejected in good faith by his corporation.[110]

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103. *Id.* at 863.
104. 121 A.2d 919 (Del. 1956).
105. *Id.* at 922.
106. *Id.* at 921.
107. *Id.* at 922.
108. *Id.* at 922, 926.
109. *Id.* at 925.
110. *Cf.* Guth, 5 A.2d at 513 (finding of fact that opportunity had not been offered to corporation by defendant as he asserted).

3. *Ratification.* The final defense recognized by the Delaware courts is ratification, which is closely allied to the defense of tender and rejection discussed above. Similar legal standards apply whether a corporation's stockholders or board of directors "reject" a corporate opportunity or "ratify" its appropriation by a corporate manager.

Ratification is effective only within certain limits. First, neither fraud nor waste may be ratified by the stockholders, except by a unanimous vote.[111] Second, ratification is not a complete defense to a claim for relief under the corporate opportunity doctrine but merely shifts the burden of proof to the party attacking the transaction. If the transaction is ratified by the disinterested directors, the normal presumption of the business judgment rule[112] will apply; if the transaction is ratified by stockholders, "the entire atmosphere is freshened and a new set of rules invoked where formal approval has been given by a majority of *independent, fully informed* shareholders."[113] The general effect of ratification is a complex issue, applicable to situations far removed from the corporate opportunity doctrine and therefore beyond the scope of this article. Professor Folk's book[114] provides an excellent general discussion of the judicial formulations of the business judgment rule, the effect of ratification and the impact of Section 144 of the Delaware General Corporation Law[115] on these related issues.

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111. Mayer v. Adams, 141 A.2d 458, 460 (Del. 1958); Kerbs v. California Eastern Airways, Inc., 90 A.2d 652, 656 (Del. 1952); Keenan v. Eshleman, 2 A.2d 904, 909 (Del. 1938); Saxe v. Brady, 184 A.2d 602, 605 (Del. Ch. 1962).

112. Beard v. Elster, 160 A.2d 731, 733, 738 (Del. 1960).

113. Gottlieb v. Heyden Chemical Corp., 91 A.2d 57, 59 (Del. 1952) (emphasis added); *accord,* Schiff v. RKO Pictures Corp., 104 A.2d 267, 270-72 (Del. Ch. 1954). *See generally* Alcott v. Hyman, 208 A.2d 501, 505-06 (Del. 1965) and cases cited therein.

114. E. FOLK, THE DELAWARE GENERAL CORPORATION LAW at 74-95 (1972 ed.).

115. § 144. *Interested directors; quorum:*

(a) No contract or transaction between a corporation and one or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present or participates in the meeting of the board or committee thereof which authorizes the contract of transaction, or solely because his or their votes are counted for such purpose if:

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the share-

Section 144's protection is negative; contracts or transactions within the statute are neither void nor voidable *solely* because those approving the transaction have an interest in it. The removal of this spectre by Section 144 does not, without more, shift the burden of proof to those opposing the transaction. It cannot be emphasized too strongly that compliance with Section 144 does *not* constitute "ratification" in the sense discussed above, as the only case construing Section 144 since its enactment in 1967, *Fliegler v. Lawrence,*[116] demonstrates. After deciding that plaintiff Agau should not develop the antimony claims itself, Agau's board approved the following plan: Lawrence himself purchased the antimony claims in late 1969. In 1970 Lawrence and five other individuals formed a new corporation (USAC) to which Lawrence assigned his antimony claims in return for 6,000 shares of USAC stock. Another 4,000 shares were issued to the other five individuals. For $10.00 the owners of USAC's stock sold Agau a two-year option to acquire each share of USAC stock for 80 shares of authorized but unissued Agau stock which would be subject to "investment letters" restricting their transferability. On June 27, 1970, Agau's board voted to exercise the option.[117] Dawson, the only disinterested director of Agau, did not cast a vote at this meeting although he had evidently approved the initial option agreement in January.[118] On October 16, 1970, Agau's stockholders voted to ratify the exercise of the option. Approximately 60% of Agau's stock was voted at the meeting and the exercise of the option was approved, after full disclosure, by an affirmative vote of 99.1%. The vote in favor of the exercise of the option by stockholders other than those who had a personal financial interest in USAC was 97.6%[119] but only one-third of the "disinterested" stockholders bothered to cast their vote.[120]

The Court of Chancery held that the Agau stockholders had ratified the option plan and that therefore the test was whether "the

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holders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee thereof, or the shareholders.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.

116. Civil Action No. 3647, 1 Del. J. Corp. L. 145 (Del. Ch. 1974), *aff'd,* 361 A.2d 218 (Del. 1976).

117. *Id.* at 149–52.

118. 361 A.2d at 222.

119. Civil Action No. 3647, 1 Del. J. Corp. L. at 152, *aff'd,* 361 A.2d 218 (Del. 1976).

120. 361 A.2d at 221.

terms of the option were so inherently unfair to Agau that it was not susceptible to shareholder ratification[;] in such event the Court will look to see only if the terms are so unequal as to amount to a waste of corporate assets" and cast the burden of proof on plaintiff.[121] The Court noted that even if defendants' stock was excluded from the vote at the October 20, 1970, stockholders' meeting, the option plan had still received overwhelming approval from the disinterested stockholders.[122] The Court concluded, applying the rule announced in *Johnston v. Greene* of whether or not the proposition would have commended itself to a wholly independent corporation,[123] that this transaction was entirely proper.[124]

The Supreme Court affirmed the Court of Chancery's holding on the applicability of the corporate opportunity doctrine[125] and the merits of the option plan[126] but set forth a markedly different rule on the issue of stockholder ratification. First, the Supreme Court stated: "Only about one-third of the 'distinterested' shareholders voted, and we cannot assume that [the] non-voting shareholders either approved or disapproved,"[127] holding that if defendants desire the freshening of the atmosphere promised by *Gottlieb,* it is up to them to procure — and prove — the vote of an absolute majority of the disinterested stockholders, rather than simply a majority of those who actually exercise their franchise. Second, the Supreme Court ruled that the General Assembly, in enacting Section 144, did not intend compliance with its procedures to shift the burden of proof to the party attacking the transaction.

> Defendants argue that the transaction here in question is protected by § 144(a)(2) which, they contend, does not require that ratifying shareholders be 'disinterested' or 'independent'; nor, they argue, is there warrant for reading such a requirement into the statute. *See* Folk, *The Delaware General Corporation Law — A Commentary and Analysis* (1972), pp. 85–86. We

121. Civil Action No. 3647, 1 Del. J. Corp. L. at 155, *aff'd,* 361 A.2d 218 (Del. 1976).
122. *Id.* at 157.
123. 121 A.2d at 925.
124. Civil Action No. 3647, 1 Del. J. Corp. L. at 157, *aff'd,* 361 A.2d 218 (Del. 1976).
125. 361 A.2d at 219–20.
126. *Id.* at 222–25.
127. *Id.* at 221. The Supreme Court's holding on this issue was foreshadowed in Schiff v. RKO Pictures Corp., 104 A.2d 267, 271 (Del. Ch. 1954). *But see* Abelow v. Symonds, 184 A.2d 173, 175–76 (Del. Ch. 1962), *aff'd on other grounds sub nom.* Abelow v. Midstates Oil Corp., 189 A.2d 675 (Del. 1963) (burden not shifted when over 95% of stock voted in favor of transaction was "interested" under unusual facts in case even though a majority of "disinterested" stock voted in favor of transaction). The cryptic statements by the Court of Chancery on this point in *Abelow* are probably no longer a persuasive statement of the rule in Delaware in the light of *Schiff* and *Fliegler.*

> do not read the statute as providing the broad immunity for which the defendants contend. It merely removes an 'interested director' cloud when its terms are met and provides against invalidation of an agreement 'solely' because such a director or officer is involved. Nothing in the statute sanctions unfairness to Agau or removes the transaction from judicial scrutiny.[128]

Finally, the Supreme Court's opinion reaffirmed the earlier Court of Chancery ruling, in the context of the business judgment rule, in *Kaplan v. Centex Corp.*[129] that those seeking the protection of that rule must demonstrate that "judgment was brought to bear with specificity on the transactions."[130] The Court rejected defendants' argument "that since defendant-director Dawson was not 'interested' and since he approved acquiring the option, the transaction falls under the protection of § 144(a)(1)," by stating, "However, Dawson, who was the only disinterested director, did not participate at the Board in which it was resolved to *exercise* the option; and it is with that decision which we are now concerned."[131]

The *Fliegler* decision may be a landmark in stockholder democracy, since it requires those who seek the protection of ratification actively to solicit an absolute majority of the "disinterested" shares entitled to vote by construing apathy strictly against them. The result seems harsh, given the difficulty of "getting out the vote" on any issue in corporate affairs in the United States of the 1970's. It seems particularly harsh in the specific circumstances of the *Fliegler* case in which there was not the slightest hint of irregularity in calling or conducting the stockholders' meeting; in which complete disclosure of all material facts was made[132] and in which the vote of those "disinterested" stockholders who did care enough about the issue to exercise their franchise was overwhelmingly in favor of ratification. Whether the ruling on this point was correct or not is open to debate, but unless the General Assembly changes it by statute or the Supreme Court reverses itself, the cautious attorney seeking ratification of his client's acts will make an extraordinary effort to get the "disinterested" stockholders to vote and will preserve the proxies and other voting records identifying not only the final total of the votes but also how each individual stockholder voted and whether he had an interest in the transaction or not.

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128. *Id.* at 222 (footnote omitted).

129. 284 A.2d 119 (Del. Ch. 1971).

130. *Id.* at 124.

131. 361 A.2d at 222 n.3.

132. *Compare In re* Chelsea Exchange Corp., 159 A. 432, 435 (Del. Ch. 1932); Cahall v. Lofland, 114 A. 54, 63 (Del. Ch. 1928).

### C. CORPORATE PLANNING AND COUNSELING.

As with any other legal issue, the chances of successfully dealing with corporate opportunity problems are significantly improved if remedial steps are taken as soon as possible rather than when the necessity for them is thrust upon an attorney by rapidly developing events.[133] The attorney representing the corporate manager should begin his reflections on the issues discussed above as he drafts the certificate of incorporation and continue them as new officers and directors are elected, as lines of business change and as opportunities are presented to his client. The concluding sections of this article contain a variety of practical suggestions for dealing with corporate opportunity problems from the point of view of counsel for the potential defendant both before and after they arise.

1. *The limited purpose corporation.* Anticipating corporate opportunity issues may lead counsel for corporate managers narrowly to circumscribe the "purpose" clause in the certificate of incorporation.[134] For example, in *Fliegler v. Lawrence,*[135] had Lawrence (who Agau's prospectus stated would "devote essentially all his time to the exploration of Agau's claims with the exception of several hours per week that he would spend . . . in private consulting work,")[136] considered it likely that other mining opportunities would come to his attention, he might have insisted that Agau's certificate of incorporation recite that it was formed *exclusively* for the purpose of exploring certain gold and silver mining claims in the Yankee Fork District of Custer County, Idaho, and that it had all powers necessary to accomplish that single purpose. This would have enabled Agau to fulfill its stated goal and to meet the expectations of all its stockholders, yet might have given the defendants in *Fliegler v. Lawrence* an additional effective defense against the claim of usurpation of an Agau corporate opportunity relating to the antimony claims in Sanders County, Montana.[137] A similar result might have been obtained in the 1971 Dela-

133. *Cf.* CALLINGHAM, SEAMANSHIP: JOTTINGS FOR THE YOUNG SAILOR, *quoted in* L. DEIGHTON, HORSE UNDER WATER at 6 (Dell ed. 1969) ("Perhaps the worst plight of a vessel is to be caught in a gale on a lee shore. In this connection the following . . . rules should be observed: 1. Never allow your vessel to be found in such a predicament . . . .").

134. 8 DEL. C. § 102(a)(3) (1974).

135. Civil Action No. 3647, 1 Del. J. Corp. L. 145 (Del. Ch. 1974), *aff'd,* 361 A.2d 218 (Del. 1976).

136. *Id.* at 148.

137. *See* Barr v. Pittsburgh Plate-Glass Co., 51 F. 33 (W.D. Pa. 1892), *aff'd,* 57 F. 86 (3d Cir. 1893) (geographic limitation); Urban J. Alexander Co. v. Trinkle, 311 Ky. 635, 224 S.W.2d 923 (1949) (corporate debt limitation).

ware Supreme Court decision in *Sinclair Oil Corp. v. Levien*[138] by similar draftsmanship in the derivative plaintiff's certificate of incorporation. Sinclair Oil Corporation (Sinclair) owned 97% of the stock of plaintiff Sinclair Venezuelan Oil Company (Sinven). Sinclair incorporated Sinven in 1922 for the purpose of purchasing and developing oil fields in Venezuela.[139] Although Sinven had twice ventured out of Venezuela, at a loss, it had confined its operations to that country since 1959.[140] Plaintiff, a minority stockholder of Sinven, claimed that Sinclair's acquisition and development of oil fields in Alaska, Canada, Paraguay and elsewhere in the world through Sinclair's other subsidiaries had deprived Sinven of those corporate opportunities.[141] The Supreme Court of Delaware ultimately found that none of these opportunities "came to Sinven independently" and were taken away by Sinclair for its own benefit and ruled against that branch of plaintiff's case. Could the same result have been achieved in a summary fashion, without years of litigation in the Court of Chancery and the Supreme Court, if Sinclair had articulated in Sinven's certificate of incorporation its long-standing policy of having separate subsidiaries develop its investments in each separate country,[142] by expressly confining Sinven's purpose to the acquisition and development of oil fields in Venezuela?

It has become increasingly common to state in certificates of incorporation that "the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware" as 8 *Del. C.* Section 102(a)(3) permits. Such language has the obvious advantage of flexibility, permitting the corporation to embark upon any new venture without the necessity of an enabling amendment of its certificate of incorporation on each occasion in welcome contrast to the single-purpose restriction on corporations and the narrow construction of their charters prevalent until the late 19th century.[143] A reversion to the earlier concept of the corporation as an entity organized for but a single venture may seem at first glance to be a troublesome step backward which may prevent the corporation from engaging in activi-

138. 280 A.2d 717 (Del. 1971).
139. *Id.* at 719.
140. *Id.* at 719, 722. The other operations had been conducted in Panama and Texas prior to World War II. Levien v. Sinclair Oil Corp., 261 A.2d 911, 913-14 (Del. Ch. 1969).
141. 280 A.2d at 722.
142. 261 A.2d at 916 n.2.
143. *See, e.g.,* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548-56 (1933) (Brandeis, J., dissenting); BALLANTINE ON CORPORATIONS § 9 (1946 ed.); 1 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 2 (perm. ed.).

ties not initially contemplated but which later become desirable.[144] Clearly a restrictive purpose clause would not be appropriate for the parent corporations of a contemporary conglomerate or broadly-diversified enterprise, although it may be well-suited to their subsidiaries. It is perhaps also inappropriate for the corporation whose directors, major officers and controlling stockholders perceive it as the exclusive vehicle for their investment capital which deserves their full-time attention. But closer analysis discloses several situations in which the concept of the limited purpose corporation has an undeniable appeal:

*Case 1.* *A*, a closely-held Delaware corporation in the coal mining business, is offered a new coal field it cannot afford to develop itself. It can, however, pay for about 80% of the cost of developing the new property. *A* forms a new subsidiary, *B* Company, and offers 20% of *B*'s stock to the public. The new coal mining venture to be developed by *B* is identical in all material respect to the other mines of the parent corporation. If *B*'s purpose clause is not restricted to the development of the particular mine involved, the managers of *A* will be confronted with a potential corporate opportunity claim by the minority stockholders of *B* every time a new coal venture is offered to them or to *A*.

*Case 2.* The directors of *C*, a residential real estate sales corporation incorporated in Delaware, want to purchase and manage the New Mall shopping center. None of *C*'s employees has any experience in this specialized field, but *C*'s directors approach *X*, an individual who has a great deal of experience in shopping center acquisition and management, who constantly acquires new centers which he manages himself. *X* would like to manage New Mall for *C* on a part-time basis (which is acceptable to *C*) and to become a director and stockholder of *C* at its request, but does not want to restrict his personal activities. *X*'s counsel, after reviewing the desires of both parties, suggests that *C*'s certificate of incorporation (which has a "general purpose" clause) be amended expressly to authorize *C* to purchase and manage New Mall but also to state that *C* shall never acquire or manage any other shopping center. This is acceptable to *X*, but not to *C* which wants to expand into this field. The final resolution of the problem is the incorporation of a wholly-owned subsidiary of *C* Company whose purpose is restricted exclusively to the purchase and operation of New Mall. *X* becomes a director and part-time employee of the new sub-

144. *See* Mason v. Rock Creek Park, Inc., 164 F. Supp. 269 (D.C.D.C. 1958), *aff'd per curiam,* 266 F.2d 695 (D.C. Cir.), *cert. denied,* 361 U.S. 833 (1959) (provision required by Federal law in certificate of incorporation of Maryland corporation against engaging in hotel business); 19 C.J.S. *Corporations* § 949.

sidiary and is given a few shares of *C*'s stock. However, *X*'s attorney advises him not to become a director of *C* in view of *C*'s interest in expanding into *X*'s own area of expertise.

*Case 3.* *D* is a Delaware corporation in the business of growing and marketing corn in the Midwest. It needs funds for expansion in its present line of business but has had very poor relations with its local banks. One of *D*'s directors is a personal friend of *Y* who is engaged in the full-time conduct of his own oil business and has excellent banking connections in New York City. *Y* is therefore invited to join *D*'s board of directors. *Y*'s attorney discovers that forty years ago *D* developed an oil well unexpectedly found under one of its cornfields and consequently its certificate of incorporation, which also contains a "general purpose" clause, specifically grants *D* the power to engage in the oil business. *Y*'s ventures in the oil business are conducted in the same Midwestern states in which *D* operates. *D* is a publicly-held corporation with several litigious minority stockholders. *Y*'s attorney advises him not to stand for election as a director until *D*'s certificate of incorporation is amended expressly to deny to *D* the power to engage in the oil business, although the general purpose clause may otherwise be left intact.

This technique puts to practical use the result under New York law in *Burg v. Horn*,[145] decided by the Second Circuit in 1967. Messrs. George and Max Horn had purchased three low-rent rooming and apartment buildings in Brooklyn prior to 1953 when, in response to the Horns' urging to "get their feet wet" in such real estate, Mr. and Mrs. Burg joined with the Horns in forming Darand, the derivative plaintiff which promptly purchased a similar building. Mrs. Burg owned one-third of Darand's stock and the corporation had an initial capital of $5,500. In 1956 Darand sold its initial building and acquired another; in 1959, it purchased two more. From 1953 to 1963 the Horns purchased nine similar properties for their own account.[146] Three of the nine buildings purchased by the Horns were financed in part by loans from Darand and Mr. Burg, but the trial court and the Second Circuit both concluded that the Burgs knew of the purpose of these loans and apparently acquiesced in them by their silence.[147] Chief Judge Lumbard wrote in the majority opinion:

> Plaintiff apparently contends that defendants were as a matter of law under a duty to acquire for Darand further properties like those it was operating. She is seemingly supported by sev-

145. 380 F.2d 897 (2d Cir. 1967).
146. *Id.* at 898–99.
147. *Id.* at 899, 901–02.

> eral commentators, who have stated that any opportunity within a corporation's 'line of business' is a corporate opportunity. *E.g.*, Note, *Corporate Opportunity*, 74 HARV. L. REV. 765, 768–69 (1961); Note, *A Survey of Corporate Opportunity*, 45 GEO. L.J. 99, 100–01 (1956). This statement seems to us too broad a generalization. We think that under New York law a court must determine in each case, by considering the relationship between the director and the corporation, whether a duty to offer the corporation all opportunities within its 'line of business' is fairly to be implied. *Had the Horns been full-time employees of Darand with no prior real estate ventures of their own, New York law might well uphold a finding that they were subject to such an implied duty.* But as they spent most of their time in unrelated produce and real estate enterprises and already owned corporations holding similar properties when Darand was formed, as plaintiff knew, we agree with [District] Judge Dooling's finding that *a duty to offer Darand all such properties coming to their attention cannot be implied absent some further evidence of an agreement or understanding to that effect.**
>
> . . . .
>
> It has been urged that the reasoning of *Johnston v. Greene* is fallacious because the fact that a director may be under fiduciary obligations to more than one corporation should lead a court to find and enforce the strongest obligation, not to allow the director to disregard them all. Note, *Corporate Opportunity*, 74 HARV. L. REV. 765, 770–771 (1961); Note, *The Doctrine of Corporate Opportunity*, 26 U. CIN. L. REV. 104, 108–109 (1957). This criticism seems to us to miss the point underscored by the facts of this case, that a person's involvement in more than one venture of the same kind may negate the obligation which might otherwise be implied to offer similar opportunities to any one of them, *absent some contrary understanding. Cf. Homestake Mining Co. v. Mid-Continent Exploration Co.*, 282 F.2d 787, 798–802 (10 Cir. 1960) (mining joint venture).
>
> * This conclusion is reinforced by the small initial capitalization of Darand, which made a plowback of profits or further capital contributions by its stockholders necessary for acquisition of additional properties.[148]

Judge Hays dissented on the ground that the Horns, who were majority stockholders and managing officers of Darand and whose primary function was to locate suitable properties for Darand, had a fiduciary obligation to offer all such properties to it before taking them for themselves. But even he would have permitted the Horns to take such opportunities for themselves if there had been an express agreement

148. *Id.* at 900–01 (emphasis added).

or understanding with Darand or the Burgs to that effect.[149] The majority thus limited the "purpose" of Darand by an examination of the underlying facts and circumstances, while the dissent took the position that such a limitation must be embodied in an express agreement to be effective. The critical factor, supported by both the majority and dissenting opinions in *Burg,* is that the stockholders of a corporation and the corporation itself are free contractually to modify the common-law rule of corporate opportunity.

The applicability of the *Burg* rule in Delaware is called into question by the decision of the Court of Chancery in *Levien v. Sinclair Oil Corp.*[150] in which Chancellor (now Justice) Duffy stated:

> Sinclair argues that the nature and extent of the fiduciary duty depends upon the circumstances of the case. Of course it does; but that simply means that the result is not known until the law is applied to the facts.
>
> Sinclair then argues that the fairness of the manner in which it "treated Venezuelan [Sinven] should be evaluated in terms of the treatment that minority stockholders like plaintiff could reasonably have expected the corporation to receive". *See Corporate Fiduciary Doctrine in the Context of Parent-Subsidiary Relations,* 74 YALE L.J. 338, 349 (1964). That would take into consideration, says Sinclair, the "realities" of the parent-subsidiary relationship.
>
> I have set out in a footnote the knowledge which Sinclair would charge to plaintiff (and, presumably to other stockholders similarly situated).** It is offered without persuasive authority and, in my judgment, it is also made without reason, because it (a) ignores the fact that the suit is for the benefit of the *corporation,* and (b) carried to its logical conclusion would mean that notice of (bad) conduct, not the conduct itself would be the criterion for recovery. A theory of "reasonable expectations" may have a place in the ebb and flow of corporate life as it relates to investment, market appraisals, and the like. But it would go against the grain of our decisions to apply it in derogation of duties we have so long regarded as fiduciary.
>
> ** Thus, in addition to the information available from a reading of Venezuelan's Certificate [authorizing contracts with corporations in which Venezuelan directors have an interest], plaintiff (as well as any minority stockholder) should have been aware that, aside from two isolated and unsuccessful instances before World War II, Venezuelan had functioned only in Venezuela. He should have been aware that

149. *Id.* at 902.
150. 261 A.2d 911 (Del. Ch. 1969).

> it had been Sinclair's longstanding policy to have a separate subsidiary handle the investments made in each separate country.... He should have been aware that it was Venezuelan's policy to relinquish concession acreage that, after study, "did not appear to warrant additional exploratory drilling." He should have been aware of the reorganization intended to qualify Venezuelan as a Western Hemisphere Corporation, and he should have been aware of the adverse market conditions prompting Venezuelan to do an ever-increasing volume of business with affiliated companies. In none of these areas can it be said that plaintiff obtained any less than what he bargained for in April 1960.[151]

This analysis is open to question on several grounds. First, the Supreme Court reversed the portion of the Court of Chancery's holding under discussion here on the ground that Sinclair was entitled to the protection of the business judgment rule because it was not engaged in self-dealing in these aspects of its relationship with Sinven.[152] The Court of Chancery had erroneously found self-dealing in the transactions, applied the "intrinsic fairness" test[153] and held that Sinclair had failed to meet the burden of proof of fairness imposed upon it.[154] Since the Supreme Court found that the Court of Chancery had applied the wrong threshold standard to the case, it reversed and remanded without reaching the comments of Chancellor Duffy quoted above on the "expectations" theory. Second, even if the Supreme Court's reversal of the lower court is read narrowly, the Court of Chancery's opinion leaves room for limitation of the corporate opportunity doctrine through the use of a "limited purpose" corporation. The Chancellor stated that the "expectations" test was based on the knowledge which Sinclair would attribute under a notice theory to all of Sinven's stockholders, "[ignoring] the fact that the suit is for the benefit of the *corporation*".[155] But did not the corporation, Sinven, have at the very least the same degree of knowledge by notice its stockholders had? More importantly, suppose Sinclair had expressly embodied the constraints on its relationship with Sinven, as set forth in the footnote quoted above in the Court of Chancery's opinion, in Sinven's certificate of incorporation, or in a management contract between the two corporations ratified by Sinven's minority stockholders? The Court of Chan-

151. *Id.* at 915, 916.
152. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719-22 (Del. 1971).
153. *Id.* at 719.
154. *Id.* at 721, 722.
155. 261 A.2d at 916.

cery's opinion does not extend to the situation in which the corporation expressly binds itself by a contractual agreement. The Chancellor's second objection was that the argument "carried to its logical conclusion would mean that notice of (bad) conduct, not the conduct itself would be the criterion for recovery."[156] This is clearly erroneous. The Delaware courts have always jealously guarded their jurisdiction to press their inquiry, even over the protests of ratification[157] or strict compliance with the procedures set forth in the General Corporation Law,[158] into the underlying fairness of interested transactions and the equitable conduct of corporate affairs. No defendant could seriously argue that mere notice of intent to seize a corporate opportunity would immunize the transaction from judicial review. The suggestion made in this section of this article amounts to more than the giving of notice; it is to embody the expectations and rights of the corporate managers, the stockholders and their corporation in the form of a contract among them, whether in the certificate of incorporation or in an employment or management contract. Given the unmalleable power of the Delaware courts to evaluate substance after disregarding form in this area, the *Sinclair* opinion should present no obstacle to the use of the limited purpose corporation.

The 1954 New Hampshire case of *Rosenblaum v. Judson Eng'r Corp.*[159] suggests that such a limitation in a certificate of incorporation could effectively bar a corporate opportunity claim for an opportunity extraneous to the corporation's purpose. Judson was organized in 1950 "for the purpose of manufacturing and selling 'mechanical devices, appliances and tools suitable for the automotive trade' and since that year [had] been engaged in the manufacture and sale of a camber-and-caster gauge and a turntable . . . both of which are designed for use by the automotive trade in the alignment of wheels on motor vehicles."[160] Defendants, directors of Judson, organized Rockmill, a partnership, to exploit a license for devices for balancing wheels and other similar uses in the automotive trade.[161] The New Hampshire Supreme Court commented:

> The fact that the wheel balancers and other devices manufactured and sold by Rockmill may not be directly competitive with the wheel aligner devices manufactured and sold by Judson is not determinative of the defendants' duties. According to the

156. *Id.*
157. Kerbs v. California Eastern Airways, 90 A.2d 652, 654–58 (Del. 1952).
158. Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437, 439 (Del. 1971).
159. 99 N.H. 267, 109 A.2d 558 (1954) (appeal from pre-trial discovery order).
160. *Id.* at 562.
161. *Id.* at 562–63.

> plaintiff's allegations Judson was not organized merely to manufacture and sell the wheel aligner devices but had as its business purpose the manufacture and sale of 'mechanical devices, appliances and tools suitable for the automotive trade' . . . The issue to be determined when this matter is heard on its merits is whether under the particular circumstances of the case the manufacture and sale of wheel balancers and other devices as undertaken by Rockmill was so 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.[162]

The fact that a corporation may be incorporated "for any lawful purpose" does not mean that every certificate of incorporation should so provide. An express restriction to one particular line of business or an express prohibition from a particular area may serve to solve corporate opportunity problems before they arise in situations like those discussed above, yet permit the corporation to pursue its normal lines of business and even expand without any meaningful restriction on its affairs. To the objection that such limited purpose clauses may prove unduly restrictive, it is sufficient to state that changed circumstances in the future may be accommodated by an amendment of the certificate of incorporation.[163] At best, an express limitation on the corporate purpose would provide grounds for a motion to dismiss a corporate opportunity complaint for failure to state a claim upon which relief can be granted, or for summary judgment, prior to trial. Failing that, the limitation should provide an additional affirmative defense for the corporate manager. At worst, nothing has been lost in the attempt.

A note of caution. The early Tennessee case of *Memphis & Arkansas City Packet Co. v. Agnew*[164] impressed a constructive trust on the profits derived by the captain of a steamboat from certain cotton transactions which he conducted entirely with the money, credit and personnel of the steamboat company. The transactions were conducted in Tennessee as the steamboat plied its trade on the Mississippi River under Captain Agnew's direction for the benefit of his employer.[165] Defendant did not contest the action on the merits, but did raise two affirmative defenses. First, the steamboat company, an Arkansas corporation, was doing business in Tennessee

162. *Id.* at 563. The case may be of limited precedential value because the only issue before the Court was defendants' objection to pre-trial discovery on the corporate opportunity claim. The language of the Court's opinion demonstrates the relevancy of the "line of business" cases to the concept of the limited purpose corporation.

163. 8 DEL. C. § 242 (1974).

164. 177 S.W. 949 (Tenn. 1915).

165. *Id.* at 949–50.

but had not qualified as a foreign corporation in that state and could not therefore call defendant to account in a Tennessee court for his Tennessee transactions. Second, the cotton transactions were *ultra vires* the steamboat company's charter.[166] The Tennessee Supreme Court held that defendant had proved both defenses beyond any doubt, but was estopped from raising them against the corporation because of his breach of trust in embarking its assets in a venture for his own personal profit.[167] With the abolition of the *ultra vires* doctrine in Delaware except in certain very limited circumstances,[168] the temptation may arise to place paper restrictions on the corporation's lines of business in its certificate of incorporation to shelter management from any application of the corporate opportunity doctrine, yet in practice to ignore all such restrictions when management deems it expedient to do so. The temptation should be avoided since the Delaware courts would not allow such a sham to insulate the offending corporate managers from liability.[169] Limiting the purpose of a corporation is a technique like the others set forth in this article which, if properly used, may wholly or partially shield the corporate manager from claims under the corporate opportunity doctrine, but which will certainly fail if they are abused.

2. *Modifying the common-law rule in the certificate of incorporation or employment contract.* Assume the same set of facts as in Case 3 above with the following changes: In the course of his discussions with *D* Company about becoming a director, *Y* comes to the conclusion that a continuing program of investment in oil wells would be most desirable for *D* since it would significantly reduce *D*'s annual Federal income tax on the large profits generated by its corn business. *Y* proposes this idea to *D*'s directors, who, after study, enthusiastically agree. *Y* therefore informs his attorney that the earlier proposal to amend *D*'s certificate of incorporation to exclude *D* from the oil business is unacceptable. Is there a method by which *Y* can protect himself from corporate opportunity claims relating to the oil business by *D*'s stockholders after he joins *D*'s board of directors and *D* begins its oil investment program?

Section 102(b)(1) of the Delaware General Corporation Law permits the certificate of incorporation to contain "any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and

166. *Id.* at 950.
167. *Id.* at 950–51.
168. 8 DEL. C. § 124 (1974).
169. Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971).

regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the members of a nonstock corporation; if such provisions are not contrary to the laws of this State." The certificate may also contain any provision which the General Corporation Law requires or permits to be set forth in the by-laws.[170] It has been suggested that a corporation may allow its officers and directors to participate in other enterprises without constantly being subjected to corporate opportunity litigation by adopting a provision in its certificate of incorporation permitting them to "hold positions as officers and directors of other corporations in related businesses and their efforts to advance such corporations will not constitute a breach of fiduciary loyalty to this corporation in the absence of a showing of bad faith."[171] Such a provision might be phrased more effectively, paralleling the language of 8 *Del. C.* §144, as follows:

(a) No contract or transaction to which a director, officer or stockholder of this corporation, or any corporation, partnership or other association in which such a person holds a managerial position or has a financial interest, is a party shall be the property of this corporation unless
  (1) the contract or transaction was offered to such person in his capacity as this corporation's agent and wrongfully appropriated by him;
  (2) this corporation had an enforceable legal interest in the contract or transaction at the time it was initially offered to such person; or
  (3) such person made substantial use of the assets, personnel, facilities or resources of this corporation in obtaining or developing the contract or transaction for his personal benefit.

(b) The existence or presence of one or more of the factors set forth in subparagraph (a) above shall not conclusively entitle this corporation to the benefit of such contract or transaction.

Note that this provision is quite different from Section 144. First, it changes the substantive case law by eliminating the line of business and expectancy tests and the amorphous concept of the "essential" opportunity. It also confines the test of the use of corporate assets in pursuit of the opportunity to a "substantial" use. Second, it is not merely negative in effect as is Section 144. It does more than remove a spectre; it explicitly validates all transactions within its scope.

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170. 8 DEL. C. § 102(b)(1) (1974).

171. Note, *Corporate Opportunity*, 74 HARV.L.REV. 765, 771 (1961).

This provision should be inserted in the certificate of incorporation rather than the by-laws for several reasons. First, the certificate of incorporation is a contract to which every stockholder is a party and in which "the broad and general aspects of the corporate entity's existence and nature are defined . . ."[172] The by-laws have traditionally been viewed in a lesser role.[173] Second, the courts in Delaware have traditionally asserted jurisdiction to strike down by-laws as "unreasonable"[174] in contrast to their narrower scope of review of certificate of incorporation provisions which are generally upheld unless they "transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself."[175] The Delaware courts have upheld charter provisions in conflict with the common law[176] and have construed Section 102(b)(1)'s prohibition of certificate of incorporation provisions "contrary to the laws of this State" as referring only to the "express words or necessary intendment" of the General Corporation Law or legal principles rising to the dignified status of public policy.[177] Finally, as a practical consideration, amendments to the certificate of incorporation must first be proposed by the board of directors before the stockholders may vote upon it.[178] On the other hand, by-laws may be made, altered or repealed by the stockholders alone and the directors may never have more than concurrent power

172. Gow v. Consolidated Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933).

173. *Id. See also* E. FOLK, *supra* note 114, at 23–24. The Minnesota Supreme Court in Diedrick v. Helm, 217 Minn. 483, 14 N.W.2d 914 (1944), treated the corporate by-law at issue in that case as binding on the stockholders to the same extent as a certificate of incorporation provision, but it is doubtful that this result would be followed in Delaware.

174. *See In re* Osteopathic Hosp. Ass'n of Delaware, 195 A.2d 759 (Del. 1963); Moon v. Moon Motor Car Co., 151 A. 298, 301 (Del. Ch. 1930); E. FOLK, *supra* note 14, at 27–28. *Cf.* State *ex rel.* Brumley v. Jessup & Moore Paper Co., 77 A. 16, 22 (Del. 1910) (by-law "unreasonable and unlawful").

175. Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 118 (Del. 1952).

176. *Id.* at 117–18; Butler v. New Keystone Copper Co., 93 A. 380 (Del. Ch. 1915); E. FOLK, *supra* note 114, at 10.

177. Aldridge v. Franco Wyoming Oil Co., 14 A.2d 380 (Del. 1940); Frankel v. Donovan, 120 A.2d 311, 316–17 (Del. Ch. 1956) (striking down charter provision in conflict with a principle "implicit" in General Corporation Law and "accepted corporation rule"); Martin Foundation, Inc. v. North American Rayon Corp., 68 A.2d 311, 316 (Del. Ch. 1949) ("I can think of no good reason why a provision defining the disqualifying 'interest' of directors more broadly or narrowly than might otherwise be the case under the Delaware common law should be considered unlawful. As interpreted, it is a perfectly lawful provision which in no way offends any policy of this state."); Greene v. E.H. Rollins & Sons, Inc., 2 A.2d 249 (Del. Ch. 1938) (restraint on alienation of stock found to "offend against what the law deems to be sound public policy"). *Contra,* State *ex rel.* Cochran v. Penn-Beaver Oil Co., 143 A. 257 (Del. Super. 1926) (reasoning of case criticized in Sterling, 93 A.2d 107 (Del. 1952)). *See* E. FOLK, *supra* note 114, at 10–11.

178. 8 DEL. C. § 242(c)(1) (1974).

with the stockholders over the by-laws.[179] In short, it seems clearly preferable to place such a provision in the certificate of incorporation rather than the by-laws in order to take advantage of the concept of the certificate as a contract to which the stockholders have assented and the more liberal standard of validity applied by the Delaware courts to certificates of incorporation. If such a provision is placed in the by-laws, it seems more likely to be upheld if the by-law is passed by the stockholders rather than the directors since it is the stockholders' economic interests which the corporate opportunity doctrine is designed to protect. Finally, in cases in which it is either not desired or not practical to amend the certificate of incorporation or by-laws, a similar provision might be inserted in the contract of employment between the corporation and a corporate manager, preferably one ratified by the stockholders. As in the case of the limited purpose concept discussed above, there is nothing to be lost by inserting this provision in the appropriate instrument, although there will certainly be a variety of opinion as to the dangers of relying too heavily on this untested clause in deciding whether or not a corporate manager should take an opportunity snared by the common-law rule but exempted by this language.

Is such a provision valid?

While the issue has never been litigated in Delaware or elsewhere, a review of the cases decided in Delaware in an area separate from the corporate opportunity doctrine but closely related to it[180] suggests that the provision would be upheld by the Delaware courts.

The related area was the counting of "interested directors" to achieve a quorum at board of directors' meetings prior to the enactment of 8 *Del. C.* Section 144 in 1967. The common-law rule in Delaware was that a director with a personal interest in a proposal before the board could not be counted for quorum purposes.[181] "The basis for the common-law rule is the prevention of conflict between duty and self-interest or divided interest. See *Italo-Petroleum Corp. v. Hannigan,* 1 Terry 534, 14 A.2d 401. However, there are many cases where there is such a conflict and the court deals with it as here, by placing

179. 8 DEL. C. § 109(a) (1974). *See* S. Arsht & L. Black, *The Delaware Corporation Law: Recent Amendments,* 30 BUS. LAW. 1021, 1021-23 (1975).

180. *Compare* the Court of Chancery's opinion in Greene v. Allen, 114 A.2d 916 (Del. Ch. 1955) (corporate opportunity) *with* the Supreme Court's reversal in Johnston v. Greene, 121 A.2d 919 (Del. 1956) (no corporate opportunity; transaction examined under self-dealing doctrine).

181. Kerbs v. California Eastern Airways, Inc., 90 A.2d 652, 659 (Del. 1952); Blish v. Thompson Automatic Arms Corp., 64 A.2d 581, 602-03 (Del. 1948); Bovay v. H.M. Byllesby & Co., 38 A.2d 808, 813 (Del. 1944) (dictum); Keenan v. Eshleman, 2 A.2d 904, 908 (Del. 1938). *Cf.* Italo-Petroleum Corp. of American v. Hannigan, 14 A.2d 401, 408 (Del. 1940) (vote of interested director cannot be counted to achieve majority).

the good faith and fairness test on those espousing the transaction."[182] The common-law rule made it impossible, under some circumstances, for corporations to take any action at all with respect to certain transactions because there were too few disinterested directors to constitute a quorum. The practice grew up of including in certificates of incorporation provisions worded almost identically to the present language of Section 144.[183] These provisions were uniformly upheld by the Delaware courts. In *Sterling v. Mayflower Hotel Corp.*[184] the Supreme Court stated:

> Turning to the charter provision before us, we find it to be one relating to the powers of the directors in conducting the corporate business. It permits interested directors to be counted toward a quorum. There is no Delaware decision dealing directly with the validity of such a provision, although in *Martin Foundation v. North American Rayon Corp.*, Del. Ch., 68 A.2d 313, the Chancellor upheld the validity of a charter provision that broadened the definition of disqualifying interest of directors for quorum purposes. In *Piccard v. Sperry Corp.*, D.C.N.Y. 1943, 48 F. Supp. 465, affirmed 2 Cir., 152 F.2d 462, Judge Rifkind was of opinion that the law of Delaware did not forbid such a provision.
>
> We see no reason to hold that stockholders may not agree that interested directors may be counted toward a quorum. Such a provision does no more than to permit the directors to act as a board, *leaving untouched questions of alleged unfairness or inequity that it is the duty of the courts in a proper case to resolve* . . . Action of interested directors under authority of such a provision will necessarily receive careful and objective scrutiny when reviewed in the courts . . . .[185]

The jurisdiction asserted by the Delaware courts to inquire into the underlying fairness of interested transactions and the equitable nature of defendants' conduct[186] was re-emphasized in the italicized portion of the passage quoted above. The Delaware courts should therefore be willing to uphold the author's suggested provision, absent facts indicating an abuse of trust, if it does not offend public policy.

To hold that the proposed restriction on the corporate opportunity doctrine offends the public policy of Delaware, it would be

182. Sterling v. Mayflower Hotel Corp., 89 A.2d 862, 866 (Del. Ch.), *aff'd*, 93 A.2d 107 (Del. 1952).

183. The complete text of Section 144 is set forth at note 115 *supra*.

184. 93 A.2d 107 (Del. 1952).

185. *Id.* at 118–19 (emphasis added); *accord*, Kaufman v. Shoenberg, 91 A.2d 786 (Del. Ch. 1952).

186. *See* text accompanying notes 157 and 158 *supra*.

necessary for the courts to reverse the holding of *Johnston v. Greene*[187] and to find that part-time employment contracts are *malum in se,* for it would be impossible to permit any corporate manager to have any interest whatsoever in any transaction not consummated for the direct benefit of his corporation alone. The teaching of the leading Delaware cases is that the corporate opportunity obligation is not an absolute one; it may not exist if the offer is made to a corporate manager in his individual capacity, if it is not in the corporation's line of business, if the corporation is in financial difficulty or for one of the host of other reasons discussed above. If the doctrine can be rendered inapplicable by accidental circumstances like these, which are inherently beyond the control of the stockholders, the corporation and the corporate manager, what reason is there to deny them the power to arrange their own affairs in this respect in a contractual agreement? Such a fundamental corporate matter as the sale of all assets with a less than unanimous stockholders' vote, absent statutory authorization to do so and in violation of the contrary common-law rule, has been contractually agreed in a certificate of incorporation and held by the Court of Chancery not to offend public policy.[188] Can the corporate opportunity doctrine claim a greater, or even equal, importance in the eyes of the law? Public policy does not demand that every stockholder be forced to employ only full-time corporate managers whose exclusive business activity must be the advancement of that corporation's affairs. The Delaware courts should therefore permit the parties expressly to contract with each other for a less intense relationship as in the provision suggested above.

3. *Anticipating evidentiary problems.* In addition to the affirmative steps outlined above for modifying the basic contractual relationships among the corporate manager, his corporation and its stockholders, there are several precautionary measures which counsel for the corporate manager should take in order to make significantly easier the proof of the recognized defenses to corporate opportunity claims or the absence of an element of the doctrine as to which plaintiff has the burden of proof. The techniques listed below neither exhaust the field nor apply to every case, but the author hopes that they and other precautions suggested by this article will prove helpful in practice.

The intent of the offeror of the opportunity as to the identity of the offeree (the corporate manager as an individual or as an agent

187. 121 A.2d 919 (Del. 1956).

188. Butler v. New Keystone Copper Co., 93 A. 380 (Del. Ch. 1915). The rule has, of course, been changed by statute since this case was decided. 8 DEL. C. § 271 (1974).

of his corporation) will not, in many cases, be readily apparent from the circumstances surrounding the offer.[189] It is therefore essential to establish at the earliest possible moment the offeror's intent and to reduce it to writing or sworn testimony. Corporate opportunity claims often lie dormant for several years,[190] and in the interval the offeror may have died — as Megargel did in the *Guth* case — or forgotten his original intent because of the passage of time. Since this intent may be decisive in a close case,[191] it is essential that a permanent record be made of it as soon as possible after the offer is made.

If the corporation has a present interest or expectancy in the opportunity, or if the opportunity may be said to be "essential" to it, the only correct action is to tender the opportunity to the corporation. A line of business situation, however, may not be as sharply defined. It would be helpful for the corporation to have a written statement of its own policy, setting forth as precisely as possible its existing areas of operation as well as those areas into which it expects or hopes to expand in the future. A sham recital which is too limited in scope or tainted by self-interest must be avoided, but a realistic statement of a company's current operations and plans will be useful not only in the event of corporate opportunity litigation but also as a practical guide for the corporate manager and his attorney in dealing with opportunities as they arise.

Corporate assets should never be used in pursuit of an individual opportunity. This rule is an absolute; even the minor use of secretarial time or a telephone paid for by the corporation may, in hindsight, take on a significance far beyond its true importance. The acceptance of an offer typed on corporate stationery, the telephonic acceptance which appears on the corporate telephone bill, or the testimony extracted from the corporate manager that yes, he did meet with the offeror in the corporate conference room during business hours while he was receiving a salary from the corporation — all have a potentially sinister cast. The underlying reality may have been quite different, but cases have been lost on evidence more tenuous than this. Business opportunities of any kind which the corporate manager wants for his own account must be pursued on his own time and outside the office.

The affirmative defense of financial or legal inability of the corporation to take the opportunity when offered is one which must be shown objectively or, if subjectively (*i.e.*, by the contemporaneous opinion of the board of directors), must not be tainted by self-interest.

189. *See* text accompanying notes 19–23 *supra*.
190. In *Guth* the delay was approximately seven years.
191. *See* text accompanying note 29 *supra*.

It is not enough that the corporate manager to whom the opportunity was offered testify that he "believed" or "felt" his corporation was barred from taking the opportunity at that time unless his testimony is independently verifiable from objective facts or records.[192] A resolution by the disinterested members of the board of directors setting forth the grounds of the inability would be most helpful in this context.

Tender of the opportunity to the corporation and its rejection should, of course, be conducted in an equally formal fashion and documented in writing. Prudence dictates that a series of slightly different terms and conditions concerning an offer be treated as a series of independent offers and tendered to the corporation on each occasion despite the fact that the holdings in the *Kaplan* and *American Investment Co.* cases may protect the corporate manager even if this is not done.[193] If it is impractical to call a board meeting every time a slight variation in the terms and conditions of a continuing series of offers is made, letters to the disinterested board members followed by their silence may be equally effective.

Finally, ratification is subject to the teaching of *Fliegler v. Lawrence* that an absolute majority of the disinterested stockholders — not just a majority of those voting — must approve the transaction under scrutiny.[194] Assuming the vote is a favorable one, counsel for the corporate manager should insist that the documents recording the vote of each individual stockholder be preserved so that he can, if necessary, demonstrate in later years the outcome of the disinterested vote.

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192. *See* text accompanying notes 82–87 *supra*.
193. *See* text accompanying notes 98–103 *supra*.
194. *See* text accompanying notes 116–32 *supra*.