CORPORATE OPPORTUNITY DOCTRINE
AND INTERESTED DIRECTOR TRANSACTIONS:
A FRAMEWORK FOR ANALYSIS IN AN ATTEMPT
TO RESTORE PREDICTABILITY

BY ERIC G. ORLINSKY*

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*Mr. Orlinsky is associated with the firm of Saul, Ewing, Remick & Saul, LLP.
Mr. Barry L. Cohen contributed to this article. The opinions expressed in this article are those of
the author and do not necessarily reflect the opinions of Saul, Ewing, Remick & Saul, LLP.

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I. INTRODUCTION

"[I]n most matters it is more important that the applicable rule of law
be settled than that it be settled right."¹ This observation is especially true
for American businesses, which must make real economic decisions each
and every day based upon the rule of law. Indeed, each day in America
corporations seek legal advice about the structuring of their affairs and
transactions. Corporations and their legal advisors are often faced with
transactions that implicate what is known in the corporate law as the duty

of loyalty. The duty of loyalty is generally owed by directors, officers, and employees to the corporation. The duty of loyalty is most often implicated when proposed transactions create a conflict between the interests of the corporation and the personal interests of the director, such as a transaction directly with the director, a transaction with another entity in which the director has an interest, or a transaction with another entity to which the director also owes a conflicting duty of loyalty. The vast majority of conflict of interest transactions can be divided into two types: "interested director" transactions and "corporate opportunities." These two types of transactions are the focus of this article and are more fully explained below.

Corporations often ask legal advisors whether a particular conflict of interest transaction can be undertaken as structured without creating liability, whether a proposed transaction can be restructured to avoid or reduce the risk of liability or whether a proposed transaction should be abandoned altogether. It is, therefore, critical to legal advisors and the corporations they advise that the law governing conflict of interest transactions be certain and predictable.

Although the law of conflict of interest transactions initially developed under the common law, nearly every state has now adopted a statute to provide a safe harbor for interested director transactions.

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2 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.10 (2d ed. 1990); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("While technically not trustees, [directors] stand in a fiduciary relation to the corporation and its stockholders. ... The rule ... requires an undivided and unselfish loyalty to the corporation ... ").

3 For simplicity, this article will refer only to the director's duty of loyalty. In nearly all situations, the duty of loyalty of officers and employees requires the same analysis and dictates the same outcome. See infra Part V.D. The few situations in which the duty of loyalty of officers and employees differs from that of directors are examined more fully below. See infra Part V.D.

4 See infra Parts III.B-C.

enacting these statutes, legislatures intended to provide greater predictability to the law of conflict of interest transactions. Unfortunately, however, courts have not always interpreted these statutes properly, have often confused interested director transactions with corporate opportunities, and worse, have lumped the two together, assuming they are the same. Courts often have difficulty with these cases because the transactions at issue are complex. Moreover, sometimes courts have greater difficulty because these complex transactions implicate both corporate opportunity issues and interested director transactions. By confusing the two doctrines, the courts have reintroduced unpredictability into at least one area in which the legislatures have sought to maintain predictability.

A primary example of the difficulty courts have had with these issues is Independent Distributors, Inc. v. Katz. Independent Distributors, which will be discussed extensively below, displays a fundamental misunderstanding of corporate law by confusing an interested director transaction with a corporate opportunity, treating the two the same, and then misapplying the principles of each. Unless Independent Distributors is to be completely disregarded, it has raised significant questions as to the operation of these two doctrines; as a result, it has injected unpredictability into conflict of interest problems in Maryland corporate law. Although the decision in Independent Distributors was the genesis for this article, Maryland is not alone in this plight. Numerous other courts, interpreting the

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6Perhaps the reason that courts have difficulty with these doctrines is that so few business or commercial practitioners are appointed to the bench today. It seems in many states in recent years that the dramatically increasing criminal dockets have caused more and more judicial appointees to come from the ranks of prosecutors and public defenders. This has caused several states to consider establishing a separate business court to hear these types of matters. See Brad Boles, States Give Special Courts the Business, 21 A.B.A. SEC. LITIG. NEWS I (1996). Whatever the solution to this problem is, clearly, the lack of business or commercial experience on the bench has contributed to the confusion between these doctrines and their application.

7See infra Part V.A.


8See infra Part V.A.1.a, note 264, & text accompanying notes 279-83.
corporate laws of their states, have also caused considerable confusion and unpredictability by misunderstanding and misapplying these two doctrines.

This article seeks to (1) create a fundamental understanding of the two doctrines by better articulating the purposes of each; (2) provide an exhaustive framework for distinguishing between the two and for analyzing transactions that implicate either, or both, of these two doctrines; (3) demonstrate how the framework should be applied to specific factual situations by analyzing the quintessential corporate opportunity and interested director situations within the framework; and finally, (4) identify and discuss certain common problem areas that have created difficulty for courts. Through the creation and acceptance of this framework, it is the goal of this article to restore certainty and predictability to the law of corporate conflict of interest transactions.

II. HISTORICAL BACKGROUND

At common law, transactions between a corporation and its director (or another entity in which the director had an interest) were voidable, regardless of whether they were approved or ratified and regardless of whether they were fair.10 This limitation evolved in the early twentieth century so that if approved by disinterested directors and found to be fair, a transaction would not be voided.11 By 1960, it was generally held that interested director transactions were not voidable unless found to be unfair to the corporation.12 Largely as a result of the uncertainty inherent in such an analysis and the difficulty in structuring transactions so as not to be voidable, states began adopting safe harbor statutes for these transactions.13 The corporate opportunity doctrine, by contrast, remains a creature of common law in every state.

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11 Marsh, supra note 10, at 39; Ruder, supra note 10, at 1387-88.
12 Marsh, supra note 10, at 43.
13 For example, Maryland's interested director statute, Md. Code Ann., Corps. & Ass'ns § 2-419 (1993), was first adopted in 1976 and was modeled on Section 41 of the Model Business Corporation Act (the predecessor to Model Bus. Corp. Act § 8.31 (1984)); Hanks, supra note 10, § 6.22[b].
III. FRAMEWORK

In an effort to restore predictability and certainty to corporate decision making, to combat the difficulties encountered by practitioners and courts associated with conflict of interest transactions, and to clear up any judicial misunderstandings or confusion, a conceptual framework for analysis (the Framework) has been developed. 14 The Framework is intended to be used as a guide in structuring proposed corporate transactions and for analyzing consummated corporate transactions for potential conflicts of interest. This is accomplished by applying the relevant facts of a particular transaction to each step of the Framework.

The following is a step-by-step breakdown of the Framework and an explanation of each step:

A. Conflict of Interest Transactions Defined

When structuring or analyzing a business transaction, one must first determine whether a potential conflict of interest exists. As previously discussed, there are primarily two types of conflicts associated with business transactions: interested director transactions and corporate opportunities. The initial step in the Framework is to determine whether a particular transaction is an interested director transaction, a corporate opportunity, neither, or both.

Nearly all states have enacted interested director transaction statutes. 15 Delaware, the preeminent jurisdiction for corporate law, defines an interested director transaction as a "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." 16 Most states use the same or a substantially similar definition. 17 Thus, an interested director transaction is

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14 A flow-chart providing a simple graphical summary of the Framework is attached as Exhibit A. The Framework generally assumes that the state law which governs the transaction includes an interested director statute modeled on that contained in the 1984 version of the Model Business Corporation Act. MODEL BUS. CORP. ACT § 8.31 (1984). As of 1992, only four states had adopted the 1988 version. A.L.I. PRINCIPLES OF CORPORATE GOVERNANCE § 5.02 reporter's note 2 (1992). Obviously, to the extent that a state's statute differs significantly, the Framework must be modified.

15 See supra note 5.


17 See statutes cited supra note 5. The Model Business Corporation Act defines conflicting interest in interested director transactions, in part, to mean:

[W]ith respect to a corporation . . . the interest a director of the corporation has
essentially a situation in which the director may be taking advantage of the corporation, to whom the director owes a fiduciary duty, by dealing directly with the corporation (either on his or her own account or on behalf of another entity in which the director has a material financial interest or to which the director also owes a fiduciary duty) in an unfair manner or at an unfair price.

A corporate opportunity, on the other hand, is a business opportunity that is presented to a director, but which the director seeks to take for his or her own personal benefit. In the case of the corporate opportunity, the director is taking advantage of the corporation to whom he or she owes a fiduciary duty by failing to offer or give a particular business opportunity to that corporation and instead taking it himself or herself, either for that director’s own account or for another entity in which that director has a material financial interest or to which that director also owes a fiduciary duty. Thus, the harm that the corporate opportunity doctrine protects against is that the director may be making for him or herself a profit that should otherwise belong to the corporation.

Simply stated, an interested director transaction statute applies where a director seeks to transact business with the corporation. Conversely, a transaction should be analyzed under the corporate opportunity doctrine where a director seeks to take an opportunity from the corporation. While courts have confused the two doctrines, each doctrine operates independently of the other. Thus, if a transaction is properly viewed under

respecting a transaction effected or proposed to be effected by the corporation (or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest) if . . . the director knows at the time of commitment that he or a related person is a party to the transaction or has a beneficial financial interest in or so closely linked to the transaction and of such financial significance to the director or a related person that the interest would reasonably be expected to exert an influence on the director’s judgment if he were called upon to vote on the transaction . . . .

MODEL BUS. CORP. ACT § 8.60 (1988). Although the Model Act definition is more comprehensive, the essence of a conflict of interest transaction is presented in the Delaware statute in a more straightforward, simple and easily understood manner. See supra text accompanying note 16. The Delaware statute closely tracks the 1984 version of the Model Business Corporation Act. MODEL BUS. CORP. ACT § 8.31 (1984). The Framework has adopted the definition in the Delaware statute, which is similar to the 1984 version, for ease of analysis and because that version is the one in effect in most states today. See A.L.I. PRINCIPLES OF CORPORATE GOVERNANCE § 5.02 reporter's note 2 (1992) (stating that as of 1992, only four states had adopted the 1988 revisions). Reference can, however, be made to the 1988 version of the Model Business Corporation Act to resolve more subtle issues. See MODEL BUS. CORP. ACT § 8.60 (1988).
the corporate opportunity doctrine, it should not also be subject to review as an interested director transaction.  

B. Corporate Opportunity Doctrine

1. Is it a Corporate Opportunity?

If a director or officer seeks to take an opportunity from the corporation, the next question is whether the opportunity is in fact a "corporate" one. While interested director transactions are largely governed by statutes, the corporate opportunity doctrine remains a creation of the common law. The doctrine, which is an integral part of a director's duty of loyalty, requires that "[i]n some circumstances . . . a director make a business opportunity available to the corporation before the director may pursue the opportunity for the director's own or another's account." Under the doctrine, four different major tests have emerged for determining whether an opportunity is a "corporate" one; namely, the interest and expectancy test, the line of business test, the capacity in which the opportunity was presented to the director, and the fairness test. In addition, courts have often considered other factors, such as whether the opportunity is essential to the corporation and whether the directors "wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity."  

In Miller v. Miller, the Supreme Court of Minnesota discussed three of these tests and the difficulty in applying them:

We have searched the case law and commentary in vain for an all-inclusive or "critical" test or standard by which a wrongful appropriation can be determined and are persuaded that the doctrine is not capable of precise definition. Rather, it appears that courts have opened or closed the business opportunity

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18 Certain multi-step transactions may involve both corporate opportunities and interested director transactions. In those instances, each step should be analyzed separately under either the corporate opportunity doctrine or as an interested director transaction. See infra Part V.A.
19 See Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939).
21 See infra notes 23-34 and accompanying text.
22 Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 155 (Del. 1996). It is interesting to note that a director's use of corporate resources to pursue a corporate opportunity for the director's personal benefit may itself be an interested director transaction, conversion, and a waste of corporate assets.
23 222 N.W.2d 71 (Minn. 1974).
door to corporate managers upon the facts and circumstances of each case and by application of one or more of three variant but often overlapping tests or standards: (1) The "interest or expectancy" test, which precludes acquisition by corporate officers of the property of a business opportunity in which the corporation has a "beachhead" in the sense of a legal or equitable interest or expectancy growing out of a preexisting right or relationship; (2) the "line of business" test, which characterizes an opportunity as corporate whenever a managing officer becomes involved in an activity intimately or closely associated with the existing or prospective activities of the corporation; and (3) the "fairness" test, which determines the existence of a corporate opportunity by applying ethical standards of what is fair and equitable under the circumstances.24

Three of these four tests were also succinctly explained in Guth v. Loft, Inc.25 as follows:

if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.26

The Guth court elaborated further on three of these tests. If, for example, the corporation has a particular or specific need for a good, service or property, then the corporation has an interest or expectancy in obtaining that good, service or property and it may be a corporate opportunity.27 If the corporation is engaged in a certain business and the opportunity relates to "an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business ...", and is one that is consonant with its reasonable needs and

24Id. at 79-80 (footnotes omitted).
255 A.2d 503 (Del. 1939).
26Id. at 511.
27Id. at 514.
aspirations for expansion," then it is in the line of the corporation's business and may be a corporate opportunity. The court also explained that in applying the line of business test "latitude should be allowed for development and expansion." When "a business opportunity comes to a ... director in his individual capacity rather than in his official capacity, and [is neither] essential to his corporation [nor] is one in which it has [an] interest or expectancy, the ... director is entitled to treat the opportunity as his own."30

The fourth test, the fairness test, is perhaps best articulated in Maryland Metals, Inc. v. Metzner:31 "Under the 'corporate opportunity' doctrine, corporate personnel are precluded from diverting unto themselves opportunities which in fairness ought to belong to the corporation."32 Although these tests provide some indication of the factors that a court might consider, the ultimate decision of whether a corporate opportunity exists is based on the facts and circumstances of each case. As articulated in Broz v. Cellular Information Systems, Inc.:33

Thus, the contours of this doctrine are well established. It is important to note, however, that the tests enunciated in Guth and subsequent cases provide guidelines to be considered by a reviewing court in balancing the equities of an individual case. No one factor is dispositive and all factors must be taken into account insofar as they are applicable. Cases involving a claim of usurpation of a corporate opportunity range over a multitude of factual settings. Hard and fast rules are not easily crafted to deal with such an array of complex situations. As this Court noted in Johnston v. Greene, the determination of "[w]hether or not a director has appropriated for himself something that in fairness should belong to the corporation is

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23Id.
24Guth, 5 A.2d at 514.
25Id. at 510.
26382 A.2d 564 (Md. 1978).
27Id. at 572 n.5 (citations omitted). Although Maryland Metals is a case involving employee competition and is often erroneously cited as a corporate opportunity case, the footnote cited refers specifically to the corporate opportunity doctrine. The Maryland Court of Appeals cites Burg v. Horn, 380 F.2d 897, 899 (2d Cir. 1967), and Guth, 5 A.2d at 511, as support for the fairness test. Interestingly, nowhere in Guth does the word "fair" or its derivatives appear in this context.
31673 A.2d 148 (Del. 1996).
'a factual question to be decided by reasonable inference from objective facts.'"}³⁴

While a "corporate" opportunity may be incapable of precise definition, directors need to achieve a certain comfort level when deciding whether to take an opportunity. Whether a transaction is "corporate" depends on two issues necessarily outside of the Framework: (1) the factual circumstances surrounding the particular transaction, and (2) which test (or tests) is utilized under the law that would govern the transaction. If the opportunity is not a "corporate" one, the director is free to appropriate the opportunity for his or her own. If the opportunity is a "corporate" one, the analysis under the Framework must proceed to the next step.

Because this test is a facts and circumstances test, it is the one piece of the analysis that is not well adapted to the Framework. It also is the least predictable or certain.³⁵ As a result, directors are well cautioned to seek experienced counsel in these matters, to err on the side of caution by assuming that a particular transaction is a corporate opportunity and, if there is any question as to whether a corporate opportunity exists, to take adequate precautions to structure these transactions to come within the judicially-created safe havens.³⁶

2. Is the Corporation Financially Able to Undertake the Opportunity?

The next step is to assess whether the corporation is financially able to undertake the opportunity at the time it is presented.³⁷ If the corporation

³⁴Id. at 155 (quoting Johnston v. Greene, 121 A.2d 919, 923 (Del. 1956) (citation omitted) (alteration in original)).
³⁵See Thorpe v. CERBCO, Inc., 676 A.2d 436 (Del. 1996), for a recent case with a particularly unpredictable and troublesome outcome on this issue.
³⁶Because a corporate opportunity is also a transaction in which something may be hidden from the corporation, it is logical for these tests to be broadly inclusive. It is better policy for directors to be forced to err on the side of concluding that a particular transaction is a corporate opportunity and to be required to disclose it to the corporation for acceptance or rejection. The corporation and the other directors cannot protect the stockholders against actions the existence of which they are unaware, thus this practice best protects the stockholders without being overly burdensome to directors. It is important to remember that the linchpin of the corporate opportunity doctrine is disclosure. See infra text accompanying note 40.
³⁷Wolfensohn v. Madison Fund, Inc., 253 A.2d 72, 76 (Del. 1969); Guth v. Loft, 5 A.2d 503, 513 (Del. 1939); Forkin v. Cole, 548 N.E.2d 795, 808 (Ill. App. Ct. 1989). The timing of the transaction as it relates to the corporation's financial condition is often critical. The corporation's financial condition must be analyzed contemporaneously with the transaction or contract being presented. See Dremco, Inc. v. South Chapel Hill Gardens, Inc., 654 N.E.2d 501, 507-08 (Ill. App. Ct. 1995) (holding that once partnership (joint venture) filed for dissolution, either party was able to pursue its corporate opportunities); Faracas v. City Vending Co., 194 A.2d 298, 300-01 (Md.
does not possess the financial ability to undertake the opportunity, the analysis ends and the director is free to take the opportunity for him or herself.\textsuperscript{38} If, however, the corporation is financially able to undertake the opportunity, the analysis continues. Unfortunately, whether the corporation is financially able to undertake the opportunity may be a difficult, subjective determination that ultimately may be made by a judge after the fact. As a result, if the corporation's financial ability is a close call, practitioners are advised not to rely on this factor in structuring corporate transactions.

3. Board of Directors Action

The third step in the corporate opportunity analysis is disclosure to the corporation's board of directors for their rejection or acceptance of the opportunity.\textsuperscript{39} The concept is simple. If an opportunity is a corporate one that the corporation is financially able to undertake, the opportunity must be presented to the corporation's board of directors. Disclosure, after all, is the linchpin of the corporate opportunity doctrine.\textsuperscript{40}

After full and adequate disclosure to the board, the directors should vote either to undertake the opportunity or to reject it. All the directors, including the interested one (i.e., the one who would benefit from the opportunity if it is rejected by the corporation) should be counted in reaching a quorum.\textsuperscript{41} In acting on the opportunity, however, only the disinterested directors' votes should count.\textsuperscript{42} If the board decides to undertake the opportunity, the analysis ends. If the board rejects the opportunity by a majority of the disinterested directors, then the director who presented the opportunity may generally pursue it for his or her own personal benefit.\textsuperscript{43}

1963) (stating that in spite of the fact that corporate intent to acquire stock was declared at a time when the corporation was insolvent, director's purchase of stock at a later date in the face of this declared objective was the usurpation of a corporate opportunity; the financial status of the corporation must be determined at the time of the challenged transaction and the corporation had since become solvent).

\textsuperscript{38}Forkin, 548 N.E.2d at 808.


\textsuperscript{40}See supra note 36.


\textsuperscript{42}See, e.g., Del. Code Ann. tit. 8, § 144(a)(1) (1991 & Supp. 1998). Although the corporate opportunity and interested director doctrines require two completely different analyses, there are elements to each analysis that are analogous. Here, for example, issues of board approval/rejection rely on the same analysis to determine interestedness of directors, and hence, efficacy of the vote. The fact that some portions of each analysis are analogous may be an additional reason courts confuse the two doctrines.

\textsuperscript{43}The individual challenging such a transaction may still be able to prove that the board was dominated or controlled by the interested director or that the board's decision constituted waste. See infra Part V.I.
4. Stockholders' Action

If, however, there are no disinterested directors, there cannot be proper rejection by the board. In such a case, the opportunity should be properly disclosed to the stockholders for a vote on whether the corporation should undertake or reject the opportunity.44 If the stockholders vote to undertake the opportunity, the analysis ends. The board should then act in accordance with the vote of stockholders and undertake the opportunity on the corporation's behalf. If the stockholders reject the opportunity by the holders of a majority of the disinterested stocks, the "interested" director may generally undertake the opportunity for him or herself.45

5. A Note on Fairness

Taking a profitable opportunity from the corporation is inherently unfair. Therefore, fairness is not a part of the corporate opportunity analysis in the same sense that it is in an interested director transaction in determining whether the transaction is fair.46 Rather, fairness only plays a small role in determining whether a corporate opportunity exits in the first place.47

C. Interested Director Transactions

1. Is it an Interested Director Transaction?

As opposed to a corporate opportunity, where a director seeks to take an opportunity from a corporation, an interested director transaction occurs when a director transacts business with the corporation and by the terms of the transaction takes advantage of the corporation.48 Delaware law defines an interested director transaction as "a 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

44See, e.g., DEL. CODE ANN. tit. 8, § 144(a)(2) (1991 & Supp. 1998). Although no state has yet adopted a corporate opportunity statute, the interested director statutes provide useful analogies for determining whether a corporation has properly rejected a corporate opportunity.
45See, e.g., id.
46This was perhaps the most egregious error committed by the Maryland Court of Special Appeals in Independent Distr., Inc. v. Katz, 637 A.2d 886, 893-94 (Md. Ct. Spec. App. 1994). See infra Part V.G. for a more extensive discussion of fairness and the Independent Distributors decision.
47See supra Part III.B.1.
48See supra notes 16-17 and accompanying text.
or officers, or have a financial interest. The statute states that no such contract "shall be void or voidable solely" because of this interest.

Although not contained in the Delaware statute, Delaware case law and the Revised Model Business Corporation Act apply a materiality standard for these transactions. The materiality standard is also adopted by the Framework.

Thus, the first step in the interested director transaction analysis is to determine whether the transaction is an interested director transaction. If it is not an interested director transaction (and assuming it is not a corporate opportunity), the transaction is not subject to attack based on conflict of interest. If it is an interested director transaction, the analysis under the Framework must proceed to the next step.

2. The Safe Harbors

The next step in the Framework is to determine whether the transaction falls under one of the statute's three safe harbors. These safe harbors are mutually exclusive: satisfying one of the three will shield a transaction from attack.

a. Board of Directors Action

First, where an interested director transaction is contemplated or has been consummated, the transaction is immune from attack if (1) there has been proper disclosure to the board of directors and (2) a majority of the

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Id. The word "solely" is occasionally used to justify decisions that hold that interested directors statutes are not safe harbors. Robert A. Wachsler, Inc. v. Florafax Int'l, Inc., 778 F.2d 547, 551 (10th Cir. 1985); Rivercity v. American Can Co., 600 F. Supp. 908, 921-22 (E.D. La. 1984); Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976); see infra notes 177-79 and accompanying text. Our interpretation is that the word "solely" is intended only to provide for circumstances in which transactions are void for reasons other than the interest, such as lack of authority of the individual entering into the transaction on behalf of the corporation, fraud, waste, or the transaction being ultra vires; within the realm of conflicts of interest, however, the safe harbors of the statute are exclusive, should end further inquiry and should insulate the transaction from attack. Model Bus. Corp. Act § 8.31 cmt. 1 (1984); Patricia A. Daniel, The Duty of Care and The Duty of Loyalty in the Revised Model Business Corporation Act, 40 VAND. L. REV. 663, 683 n.109 (1987); see also infra Part V.E (concluding that interested director statutes were designed to be safe harbors).

directors not interested in the transaction approve the transaction. If both criteria are met, the transaction is generally not void or voidable because there was an interested director.

b. Stockholder Action

Second, and independent of disinterested director approval, the transaction is immune from attack if (1) there has been proper disclosure to the corporation's stockholders and (2) the holders of a majority of the stocks not interested in the transaction approve the transaction. This method of approval is typically used when there are no disinterested directors. If both criteria are met, the transaction is generally not void or voidable because there was an interested director.

c. Fair and Reasonable

The third and final method of insulating the transaction under the statute is to prove that the transaction is fair and reasonable to the corporation. Thus, even if neither of the approval safe harbors is met, then the transaction is still not void or voidable if it is fair and reasonable to the corporation. Obviously, in structuring transactions it is better to comply with one of the two approval safe harbors; their criteria are fairly objective and usually easy to satisfy. Reliance on the third, fair and reasonable, safe

3Del. Code Ann. tit. 8, § 144(a)(1) (1991 & Supp. 1998). Recently, the Delaware Court of Chancery stated, "[E]ven if a board's action falls within the safe harbor of section 144, the board is not entitled to receive the protection of the business judgment rule." Cooke v. Oolie, No. 11,134, 1997 Del. Ch. LEXIS 92, at *34 (Del. Ch. June 23, 1997), reprinted in 23 Del. J. Corp. L. 775, 796 (1998). Further, "[o]ncompliance with section 144 merely shifts the burden to the plaintiffs to demonstrate that the transaction was unfair." Id. (footnote omitted). This statement is largely inconsistent with prior Delaware decisions and has been strongly criticized. We agree with its critics and discuss Cooke in depth below. See infra Parts V.A.1.c & V.E. Despite the potential change in Delaware law signaled by Cooke, the Framework takes the position that proper disinterested director (or stockholder) approval immunizes the transaction and that fairness should not be examined unless domination or waste are alleged and proven.

4Del. Code Ann. tit. 8, § 144(a) (1991 & Supp. 1998). The individual challenging such a transaction may still be able to prove that the board was dominated or controlled by the interested director or that the decision of the board was so egregious that it constituted waste. See infra Part V.I.


6Id. § 144(a). The individual challenging such a transaction may still be able to prove that the stockholders were dominated or controlled by the interested director or that the decision of the stockholders, if less than unanimous, constituted waste. See infra Part V.I.


8Id.
harbor is, of course, far more subjective and far less certain or predictable.\(^{58}\) It is important to note that if neither of the approval safe harbors is met and the transaction is attacked, the person asserting the validity of the transaction bears the burden of proving that it was fair and reasonable.\(^{59}\)

**IV. TYPICAL CORPORATE OPPORTUNITY AND INTERESTED DIRECTOR CASES**

**A. Corporate Opportunity**

The quintessential corporate opportunity case is *Guth v. Loft*.\(^{60}\) *Guth* recognizes nearly all of the tests for determining the existence of a corporate opportunity and discusses many of them at length.\(^{61}\) With respect to many of these tests, *Guth* remains the leading authority. In addition, *Guth* addresses two situations in which a corporate opportunity exists, and yet the director is entitled to undertake the opportunity: (1) where the corporation is financially unable to undertake the opportunity and (2) where the corporation has rejected the opportunity.\(^{62}\) Finally, *Guth* recognizes the dominating director doctrine, the only situation in which "disinterested" director rejection of the opportunity may be negated.\(^{63}\)

More than fifty years later, *Guth* remains the preeminent case discussing the corporate opportunity doctrine. Because of *Guth's* preeminence in the development of this doctrine, it is the principal authority for much of the corporate opportunity portion of the Framework.\(^{64}\) The following sections explain the *Guth* decision in depth, highlight those pieces of the Framework that are derived from *Guth*, and analyze *Guth* according to the remainder of the Framework.

1. Facts

The *Guth v. Loft* saga began in May of 1931 when Charles G. Guth, the president of Loft Incorporated, a candy, beverage, and food manufacturer and retailer, became dissatisfied with the price Loft was paying for Coca-

\(^{58}\)See infra Part V.G for an extensive discussion of fairness standards.

\(^{59}\)See infra Part V.I for a discussion of the burden of proof.

\(^{60}\)5 A.2d 503 (Del. 1939).

\(^{61}\)Id.

\(^{62}\)Id. at 510-11, 513.

\(^{63}\)Id. at 508-09.

\(^{64}\)See supra Part III.B.
Cola syrup. At that time, Coca-Cola was dispensed at all 115 Loft Stores up and down the east coast. On May 19, 1931, Guth asked one of the Loft vice-presidents to look into replacing Coca-Cola with less expensive Pepsi-Cola. Unbeknownst to Guth, the day before, May 18, 1931, National Pepsi-Cola Company (NPC) had filed for bankruptcy.

Soon thereafter, Guth was approached by Megargel, the owner of NPC, who informed Guth that he was in a position to acquire the Pepsi secret formula and trademark from the bankruptcy trustee. In August of 1931, Guth and Megargel formed the Pepsi-Cola Company and acquired the Pepsi secret formula and trademark. Guth, at the time heavily indebted, then used Loft's working capital, plant facilities, materials, credit, executives, and employees to further the business of the Pepsi-Cola Company.

Guth carried out his plan of replacing Coca-Cola with Pepsi-Cola at all of the Loft Stores. As a result, Loft apparently suffered large profit losses. Guth claimed that he had offered Loft the opportunity to take over the Pepsi-Cola enterprise and had informed them that if they did not, he would; Guth further claimed that the board of Loft had declined because: (1) Pepsi was a failure, (2) manufacturing Pepsi was not in Loft's line of business, (3) Loft was not equipped to operate on such an extensive scale, and (4) the venture presented too great a financial risk. Curiously, he also claimed that the same directors had consented to Loft providing unlimited facilities and resources to Pepsi upon Guth's guarantee of the resources advanced, and upon Pepsi's contract to furnish a continuous supply of syrup to Loft.

The chancellor found, inter alia, that Guth had never offered the Pepsi opportunity to Loft; that Guth's use of Loft's money, credit, facilities and personnel for the benefit of Pepsi was without the knowledge or authorization of Loft's directors; that Guth's personal guarantee to Loft against the potential losses arising from the Pepsi venture was worthless; and

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65Guth, 5 A.2d at 505.
66Id.
67Id.
68Id.
69Guth, 5 A.2d at 506.
70Id. Initially, Megargel, the owner of NPC, was to be issued 100,000 stocks; Guth was to be issued 10,000 stocks; and 100,000 were to remain in the treasury. When the stocks were actually issued, Guth had his stocks issued in the name of the Grace Company, Inc., another company that was solely owned by Guth and his family. Id. at 505-06.
71Id. at 505.
72Id. at 507.
73Guth, 5 A.2d at 507.
74Id.
75Id.
that, until July, 1934, Loft bore practically all of the financial burdens of Pepsi, but for which Pepsi would have failed. In essence, the chancellor found that Guth had usurped a corporate opportunity of Loft. The chancellor ordered Guth to transfer all of the stock of Pepsi to Loft, and to account for and pay over to Loft all dividends, profits, salary, and gains attributed to Pepsi.

2. The Court's Decision

On appeal, the Supreme Court of Delaware set forth, and explained in depth, the rules, tests, and exceptions governing corporate opportunities — the vast majority of which remain the law of this doctrine in most states. The Guth court defined a corporate opportunity as follows:

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

This concise statement of the corporate opportunity doctrine contains three of the four recognized tests for determining the existence of a corporate opportunity.

The Guth Court elaborated on these three tests. First, the Court discussed how the opportunity came to Guth.

[W]hen a business opportunity comes to a corporate officer or director in his individual capacity rather than in his official capacity, and the opportunity is [neither] essential to his corporation [nor] is one in which it has [an] interest or expectancy, the officer or director is entitled to treat the opportunity as his own . . .

76 Ibid. at 507-08.
77 Guth, 5 A.2d at 508.
78 Ibid.
79 Ibid. at 510-15.
80 Ibid. at 511.
81 See supra Part III.B.1 for a discussion of these four tests.
82 Guth, 5 A.2d at 510.
The court noted that Megargel had years of experience in this industry and could not believably have hoped to compete with Coca-Cola by ordinary methods. The court rationalized that "[i]t would seem clear, from any reasonable point of view, that Megargel sought to interest someone who controlled an existing opportunity to popularize his product by an actual presentation of it to the consuming public." Guth was such a person because he was the President of Loft. The court concluded: "It is entirely reasonable to infer that Megargel approached Guth as president of Loft... Every reasonable inference points to this conclusion... It was a matter of indifference to Megargel whether his co-adventurer was Guth personally, or Loft..."

Second, the court addressed whether the opportunity was in the line of Loft's business. The court noted: "The phrase [in the line of business] is not within the field of precise definition, nor is it one that can be bounded by a set formula. It has a flexible meaning which is to be applied reasonably and sensibly to the facts..." The court explained:

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

The court also recognized that "[c]onceding that the essential of an opportunity is reasonably within the scope of a corporation's activities, latitude should be allowed for development and expansion. To deny this would be to deny the history of industrial development." Applying this to the facts of the case, the court found that the opportunity was within the line of Loft's business. The court concluded:

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83 Id. at 512.
84 Id. at 513.
85 Id.
86 Guth, 5 A.2d at 513.
87 Id. at 514.
88 Id.
89 Id.
90 Guth, 5 A.2d at 514.
The manufacture of syrup was the core of the Pepsi-Cola opportunity. The manufacture of syrups was one of Loft's not unimportant activities. It had the necessary resources, facilities, equipment, technical and practical knowledge and experience. The tie was close between the business of Loft and the Pepsi-Cola enterprise.\textsuperscript{91}

Third, the court analyzed whether Loft had an interest or expectancy in the Pepsi opportunity. The court found that "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 . . . ."\textsuperscript{92} The court elaborated:

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 . . . as a replacement; and when the Pepsi-Cola 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.\textsuperscript{93}

Thus, the court determined that Guth, through his own actions, had created an interest or expectancy for Loft.\textsuperscript{94} Having determined that the opportunity came to Guth in his capacity as the president of Loft, and not in his individual capacity; that the opportunity was in Loft's line of business; and that Loft had an interest and expectancy in the opportunity, the court held that the Pepsi opportunity was a corporate opportunity of Loft.\textsuperscript{95}

In Guth, the court also considered whether, despite the existence of a corporate opportunity, Guth would nonetheless be allowed to undertake the opportunity without liability.\textsuperscript{96} First, the court considered whether Guth was excused from liability for undertaking the opportunity because Loft was financially unable to do so.\textsuperscript{97}

\begin{itemize}
\item \textsuperscript{91}Id.
\item \textsuperscript{92}Id.
\item \textsuperscript{93}Id.
\item \textsuperscript{94}Guth, 5 A.2d at 514.
\item \textsuperscript{95}Id. at 515.
\item \textsuperscript{96}Id. at 513.
\item \textsuperscript{97}Id.
\end{itemize}
The appellants suggest a doubt whether Loft would have been able to finance the project along the lines contemplated by Megargel, viewing the situation as of 1931. The answer to this suggestion is two-fold. The Chancellor found that Loft's net asset position at that time was amply sufficient to finance the enterprise, and that its plant, equipment, executives, personnel and facilities, supplemented by such expansion for the necessary development of the business as it was well able to provide, were in all respects adequate. The second answer is that Loft's resources were found to be sufficient, for Guth made use of no other to any important extent.98

In addition, the court examined whether Guth was excused from liability for having undertaken the opportunity because Loft had rejected the opportunity. "Guth claimed that he offered Loft the opportunity to take over the Pepsi-Cola enterprise, frankly stating to the directors that if Loft did not, he would; but that the Board declined . . . ."99 Guth also claimed that "the Loft directors consented, without a vote, that Loft should extend to Guth its facilities and resources without limit upon Guth's guarantee . . . and upon Guth's contract to furnish Loft [with] syrup . . . . The guaranty was not in writing if one was made, and the contract was not produced."100 The chancellor found that Guth did not offer the opportunity to Loft.101 The appellate court stated: "In the Court below, the defendants strove strenuously to show, and to have it believed, that the Pepsi-Cola opportunity was presented to Loft by Guth, with a full disclosure by him that if the company did not embrace it, he would."102 "He did not offer the Pepsi-Cola opportunity to Loft, but captured it for himself."103 By upholding the chancellor's finding that the opportunity was not offered to Loft, the court determined that the proper rejection of the opportunity by Loft had not occurred.

Guth could not avail himself of either of the two excuse doctrines — financial ability and rejection104 — and was found liable for usurping a

98Guth, 5 A.2d at 513.
99Id. at 507.
100Id.
101Id.
102Guth, 5 A.2d at 513.
103Id. at 515.
104See supra Parts III.B.2-4 for a discussion of these doctrines.
corporate opportunity of Loft. As the remedy, the court imposed a constructive trust on the Pepsi-Cola opportunity for the benefit of Loft.

3. Application of the Proposed Framework to Guth

In determining whether a corporate opportunity existed, the Guth court applied three of the four recognized tests: the line of business test, the interest and expectancy test, and the capacity in which the opportunity was presented to the director. With respect to these three tests, the court's rulings are entirely in accord with the Framework. The Guth court did not discuss the fourth test, the fairness test: whether the opportunity was one which, based on all the facts and circumstances, in fairness ought to belong to the corporation. Although the Guth court did not consider this test, it is clear — given that the opportunity met the other three criteria — that the opportunity was one which in fairness belonged to the corporation. Likewise, it is clear from all the tests, whether measured by the Framework or as the Guth court actually held, that the Pepsi opportunity was a corporate opportunity of Loft.

The Guth court also properly analyzed whether Guth was excused from liability for usurping the opportunity because the corporation was financially unable to undertake the opportunity. Based on the facts as presented in the Guth opinion, Loft had adequate financial resources to undertake the opportunity. Here too the Guth court's analysis is in accord with the Framework.

As to rejection by the corporation, however, the issue is somewhat more complicated. The Guth court concluded that: (1) the opportunity was never presented to the corporation and (2) Guth dominated the board of directors of Loft. Having concluded that Guth never presented the

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105 Guth, 5 A.2d at 515.
106 Id. at 510-11.
107 See supra Part III.B.1.
108 See supra text accompanying notes 31-32.
109 Guth, 5 A.2d at 513.
110 Id.
111 Id. at 515.
112 The Court stated:
Guth was not merely a director and the president of Loft. He was its master. It is admitted that Guth manifested some of the qualities of a dictator. The directors were selected by him. Some of them held salaried positions in the company. All of them held their positions at his favor. Whether they were supine merely, or for sufficient reasons entirely subservient to Guth, it is not profitable to inquire. It is sufficient to say that they either willfully or negligently allowed Guth absolute freedom of action in the arrangement of Loft's activities . . . .
opportunity to Loft, the Guth court's analysis of rejection should have ended. There are, however, certain curiosities in the court's opinion on this issue. According to the opinion, the only evidence on this subject was given by Guth and was to the effect that he had presented the opportunity to the board of directors.\textsuperscript{113} There is no indication in the opinion that any evidence to the contrary on this issue was presented by Loft. According to the Framework, the burden of proof is on the individual challenging the transaction to prove that a corporate opportunity exists. Once the challenger successfully proves the existence of a corporate opportunity, the burden shifts to the director to prove either that the transaction was rejected or that the transaction was fair.\textsuperscript{114}

Assuming, \textit{arguendo}, that Guth proved he had presented the opportunity to Loft, the court should have determined whether the opportunity was rejected by a majority of the disinterested directors after full disclosure of the facts.\textsuperscript{115} Guth presented evidence, not only that he presented the opportunity to the directors and that he disclosed his interest, but that the other directors rejected the opportunity.\textsuperscript{116} There is no indication in the opinion that evidence was presented that demonstrated either that the directors did not reject the opportunity or that Guth did not fully disclose a material fact. In order to determine if this rejection was legally sufficient, the Guth court should have considered each director's situation independently and determined whether each director was disinterested.\textsuperscript{117} Clearly, no facts were articulated in the opinion that suggested that any of the directors, other than Guth, had a material, financial interest, or any interest for that matter, in the opportunity — the Pepsi-Cola Company. This is the primary concern as to a director's interest. Moreover, under Delaware law, directors are presumed to be independent and disinterested, unless proven otherwise.\textsuperscript{118} Assuming that the directors are not interested in the opportunity, the burden of proving that they are somehow otherwise interested falls heavily on the plaintiff.\textsuperscript{119}

In Guth, the court seemed to find that the directors were all interested because the board was so completely dominated by Guth that they could

\textsuperscript{Id. at 512.}

\textsuperscript{113}Guth, 5 A.2d at 507.

\textsuperscript{114}See infra Part V.I (discussing the shifting burdens of proof in conflict of interest transactions).

\textsuperscript{115}See supra Part III.B.3 for a discussion of this step of the Framework.

\textsuperscript{116}Guth, 5 A.2d at 507.

\textsuperscript{117}See supra note 42 and accompanying text.

\textsuperscript{118}Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984).

\textsuperscript{119}Id. at 816.
never be disinterested where he was concerned. The court even went so far as to analogize Guth to a dictator. This type of "interested" director situation is discussed at length below and has been referred to as the "dominating director doctrine." Certainly, the court must have had reason from the testimony and the record to believe that Guth dominated the other directors. In the opinion, however, the court only points to two indicia of domination: Guth selected the other directors and some of the directors were salaried employees of Loft. Neither of these two factors alone should have led the court to conclude that these directors were incapable of exercising their judgment in the interests of the corporation. One can only assume that there was some other evidence of domination in the record that led the court to conclude that Guth dominated the Loft board. Certainly, if there was no other evidence, the court should have found that the directors, other than Guth, were not interested. Had the court found that the opportunity was presented to Loft, that the material facts were fully disclosed, that the directors were not interested, and that the directors rejected the opportunity, Guth should not have been held liable for undertaking the Pepsi opportunity. Although we do not believe that all of these facts existed in the Guth case and we recognize that the burden fell on Guth to prove rejection, we do believe that the court could have better articulated the evidence and factors, or lack thereof, that led it to hold that corporate rejection did not occur. Because the issue of rejection by the stockholders was not implicated by the facts presented in Guth, this section does not address that portion of the Framework except to note that if such a rejection had been alleged, it would have to be judged by the same factors as rejection by directors and would yield the same result.

120Guth, 5 A.2d at 512.
121Id.
122See infra Part V.F.
124Guth, 5 A.2d at 512.
125Delaware law in other more recent cases has specifically held that these items without more are insufficient to establish domination. See, e.g., Aronson, 473 A.2d at 815-17. Although not expressly relied upon by the court in finding that Guth dominated Loft, perhaps the court concluded that, if Guth was in a position to use Loft's resources for his own personal venture without challenge, he must have dominated Loft.
126See supra Part III.B.4 for the discussion of this portion of the Framework.
Finally, the Guth court considered the appropriate remedy to rectify the usurpation by Guth of this opportunity. It is well established, and the Guth court so held, that this breach of a director's duty can only be remedied by imposing a constructive trust on the opportunity for the benefit of the corporation. This remedy is as provided in the Framework.

B. Interested Director Transactions

The interested director transaction involves a transaction or contract between the corporation and either a director personally, an entity in which the director owns a material, financial interest, or an entity to which the director also owes a fiduciary duty. Such was the case in Fliegler v. Lawrence, which was selected not because it is a significant case in the evolution of the interested director doctrine, but because its facts allow a comprehensive analysis under all levels of the Framework.

1. Facts

In Fliegler, Irving Fliegler, a stockholder of Agau Mines, Inc. (Agau), brought a stockholder derivative suit against Agau's officers and directors and against the United States Antimony Corporation (USAC) alleging that the directors and officers of Agau usurped a corporate opportunity and had wrongfully profited from a contract to which Agau was a party. The case arose out of the acquisition of certain antimony properties initially identified by John C. Lawrence, the president and a director of Agau. In November of 1969, Lawrence acquired these antimony properties in his individual capacity under a lease option. Lawrence offered to transfer the properties to Agau, but after discussing that possibility with the board, the board

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117Guth, 5 A.2d at 510-11.
118The court stated: "If, in such circumstances, the interests of the corporation are betrayed, the corporation may elect to claim all of the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired," and "a constructive trust is the remedial device through which precedence of self is compelled to give way to the stern demands of loyalty." Id. at 511, 510.
120361 A.2d 218 (Del. 1976).
121The supreme court summarily upheld the ruling of the chancery court as to the corporate opportunity claim. Id. at 220. The chancery court had held that the directors and officers did not usurp a corporate opportunity because Agau could not either financially or legally accept the opportunity at the time it was offered. Id.
122Id.
123Id. at 219.
124Fliegler, 361 A.2d at 219.
concluded that Agau was not in a legal or financial position to undertake the acquisition and development of the properties.\textsuperscript{135} Instead, the properties were transferred to USAC, a corporation formed solely for the purpose of acquiring the properties at issue.\textsuperscript{136} The majority of the USAC stock was owned by the directors and officers of Agau, individually.\textsuperscript{137} In connection with the transfer of the properties to USAC, the Agau officers and directors caused USAC to grant a long term option to Agau, under which Agau could acquire all of the issued and outstanding stocks of USAC in exchange for Agau stock if the properties proved to be valuable.\textsuperscript{138} The option was apparently approved by the board of directors of Agau, all but one of whom were interested in USAC.\textsuperscript{139} The option ratio calculation was intended to include reimbursement to USAC and its stockholders for their costs in developing the properties.\textsuperscript{140} In July 1970, the Agau board exercised the option.\textsuperscript{141} In October 1970, the Agau stockholders approved the exercise by a majority vote.\textsuperscript{142}

2. The Court's Decision

Initially, the \textit{Fliegler} court identified two issues arising from the antimony properties transaction. First, the court concluded that the opportunity to acquire the antimony claims was a corporate opportunity.\textsuperscript{143} Second, the court explained that the negotiation and exercise of the option was an interested director transaction.\textsuperscript{144} Once the court determined that the

\textsuperscript{135}Id. at 219-20.

\textsuperscript{136}Id. at 220.

\textsuperscript{137}Id.

\textsuperscript{138}Fliegler, 361 A.2d at 220.

\textsuperscript{139}Id. at 222 n.3. The Delaware Supreme Court opinion does not provide many facts about the board's approval. For example, it does not explain who each of the directors were and how they were each interested. Ultimately, the court finds that the board's approval was insufficient because Dawson, the only disinterested member of the board, only participated in the meeting at which the option agreement was approved and did not participate in the meeting at which the option was exercised. Id.

\textsuperscript{140}Id. at 220. The costs were expected to range from $250,000 to $500,000. The parties agreed that 800,000 Agau stocks, then trading between $3\% and $1\frac{1}{4}\text{ per stock, after a discount for liquidity, would be within the range of expected costs. Id.}

\textsuperscript{141}Id.

\textsuperscript{142}Fliegler, 361 A.2d at 220.

\textsuperscript{143}Id. The court summarily resolved this issue. See supra note 131.

\textsuperscript{144}Fliegler, 361 A.2d at 220-21. By dividing the transaction into its separate elements and holding that the acquisition of the property was a corporate opportunity and the consummation of the option was an interested director transaction, the court provides a textbook analysis of a complex transaction. Complex transactions are discussed at length below. See infra Part V.A.
option presented an interested director situation, the court addressed the defendant's contention that the stockholders had ratified the board's decision to exercise the option. The court explained the impact of stockholder ratification: "[S]hareholder ratification of an 'interested transaction', although less than unanimous, shifts the burden of proof to an objecting stockholder to demonstrate that the terms are so unequal as to amount to a gift or a waste of corporate assets." "[T]he entire atmosphere is freshened and a new set of rules invoked where formal approval has been given by a majority of independent, fully informed [stock]holders. The Fliegler court then applied the principals stockholder ratification to the facts of the case.

The purported ratification by the Agau shareholders would not affect the burden of proof in this case because the majority of shares voted in favor of exercising the option were cast by

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145 Although the court's opinion fails to identify all of the directors and explain each of their interests, it is clear that Lawrence was an interested director vis-à-vis Agau. Fliegler, 361 A.2d at 219-20. This fact alone would warrant the conclusion that the option was an interested director transaction.

146 Id. at 221. In a footnote, the court distinguished between acquiring and exercising the option, and considered the point in time at which the transaction must be analyzed for fairness.

147 The date at which this transaction must be scrutinized for intrinsic fairness is critical to the resolution of this question. We agree with the Vice-Chancellor that as of January 28, 1970, when the option was formally executed, that the transaction was one which would have commended itself to an independent corporation in Agau's position. However, we are not concerned so much with Agau's acquisition of the option, but rather with the exercise thereof and implementation of its terms. In other words, the focus must be on the actual exchange of the Agau's stock for USAC's stock and the test is whether that which Agau received was a fair quid pro quo for that which it had to pay. Since that exchange did not occur until October, 1970, we must examine the transaction as of that point in time.

Id. at 221 n.2 (citations omitted). The distinction between the acquisition of and the exercise of the option is discussed further below. See infra notes 166-71 and accompanying text.

148 Fliegler, 361 A.2d at 221 (citing Gottlieb v. Heyden Chem. Corp., 91 A.2d 57, 58 (Del. 1952)). The shifting burdens of proof and persuasion are discussed below. See infra Part V.I. It should be noted that a gift or waste of corporate assets is permitted if unanimously approved by the stockholders. Anything less than unanimity is insufficient. Michelson v. Duncan, 407 A.2d 211, 224 (Del. 1979); Kerbs v. California E. Airways, Inc., 90 A.2d 652, 655-56 (Del. 1952); Pittman v. American Metal Forming Corp., 649 A.2d 356, 364 (Md. 1994); Schreiber v. Pennzoil Co., 419 A.2d 952, 957 (Del. Ch. 1980); Saxe v. Brady, 184 A.2d 602, 605 (Del. Ch. 1962); Gottlieb v. McKee, 107 A.2d 240, 242 (Del. Ch. 1954); 3 William M. Fletcher, Cyclopedia of the Law of Private Corporations § 982, at 678 (perm. ed. 1994). Thus, if unanimous common stockholder approval has been obtained, so long as creditors or preferred stockholders are not adversely affected, an interested director transaction, no matter how unfair to the corporation, would be insulated because it is no different than a waste of corporate assets that has received unanimous stockholder approval.

149 Fliegler, 361 A.2d at 221 (quoting Gottlieb, 91 A.2d at 59) (alterations in original).
defendants in their capacity as Agau shareholders. Only about one-third of the "disinterested" shareholders voted, and we cannot assume that such non-voting shareholders either approved or disapproved. Under these circumstances, we cannot say that "the entire atmosphere has been freshened" and that departure from the objective fairness test is permissible.\(^{149}\)

The Fliegler court also addressed the defendants' contention that the transaction was protected by the Delaware interested director statute.\(^{150}\) The defendants argued that the transaction was protected by section 144(a)(2) because it was ratified by the stockholders.\(^{151}\) The defendants further contended that section 144(a)(2) did not require that the ratifying stockholders be "disinterested" or "independent" and that a disinterested stockholder requirement could not be read into the statute.\(^{152}\) Similarly, the defendants argued that because the acquisition of the option was approved by Dawson, the sole disinterested director, the transaction was immune from challenge under section 144(a)(1).\(^{153}\) The court responded:

We do not read the statute as providing the broad immunity for which 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.\(^{154}\)

The court specifically rejected the defendants' section 144(a)(1) claim because Dawson "did not participate at the Board meeting in which it was resolved to exercise the option; and it is with that decision which we are now concerned."\(^{155}\)

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\(^{149}\)Id.


\(^{151}\)Fliegler, 361 A.2d at 222.

\(^{152}\)Id.

\(^{153}\)Id. at 222 n.3.

\(^{154}\)Id. at 222. Essentially, the court determined that § 144 was not a safe harbor. The issue of whether interested director statutes are safe harbors is discussed elsewhere. See infra Part V.E.

\(^{155}\)Fliegler, 361 A.2d at 222 n.3.
Having held that neither the disinterested director approval nor the stockholder ratification were sufficient as a matter of law to protect the transaction and that, in any event, section 144 was not a safe harbor, the Fliegler court turned to the issue of fairness. Specifically, the court examined whether the decision to exercise the option was fair to Agau. Certainly, the exercise of the option would have been unfair to Agau if, for example, at the time the option was exercised, the directors knew or believed that it would result in USAC's stockholders receiving Agau stock worth more than the value of USAC. In this example, the decision to exercise would have benefitted the interested directors to the detriment of Agau.

The court first analyzed the plaintiff's theory that, by the time the option was exercised, Agau was exchanging stock worth $1.2 million for a company with only $83,000 in capital stock and with a $300,000 liability. The court then analyzed the relative values of Agau and USAC using several

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156 Id. at 222.
157 Id.
158 The court explained:
As of the critical date, the market value of Agau shares had risen and shares were being traded at about $3.00 per share; thus, while initially the maximum discounted market value of the 800,000 [shares] was considered to be $500,000, by the time in question it was $1.2 million. Development expenses [of the USAC properties], originally anticipated to range from $250,000 - $500,000, but as actually incurred, were towards the lower end of that scale.

Id. Further, the plaintiff pointed to the fact that an original subscriber for USAC's stock had backed out forcing USAC to borrow $300,000, and that only $83,000 in capital was raised from the sale of stock. Id.

On the basis of these changed conditions and in light of the fact that the exchange price was originally calculated simply to reimburse the USAC shareholders for their costs, plaintiff argue[d] that the issuance of 800,000 shares of Agau stock, having a market value of at least 1.2 million dollars, to acquire a corporation in which only $83,000 in cash had been invested, and whose property was subject to loans of $300,000, is patently unfair.

Id. at 223. The court recognized that the plaintiff's argument impermissibly equated and compared two different standards of value, market value and debt/equity ratio. Id. The court also correctly implied that the debt/equity ratio was not an accepted standard of valuation. Id.
different valuation methods, including market value, book value, and going-concern value.\textsuperscript{159} Ultimately, the court concluded "that defendants [had] proven the intrinsic fairness of the transaction."\textsuperscript{162}

\textsuperscript{159}The court stated:
In fact, a reference to market sales of the stock involved, might support a finding of fairness. It appears that, although USAC was closely held, there was one arm's-length sale of 75 USAC shares to non-affiliated investors for $160. per share. At this rate, the value of the 10,000 USAC shares would be 1.6 million, $400,000, more than the value of the shares given up by Agau.

\textit{Fliegler}, 361 A.2d at 223. Furthermore, the court noted that:
the market value of Agau's stock, even discounted, is an unrealistic indicator of the true value of what Agau gave up as it was clearly inflated due to Agau's possession of the option to acquire USAC whose properties were increasing in value largely as a result of the time and efforts expended by the individual defendants.

\textit{Id.}

\textsuperscript{160}The court stated:
The book value of 800,000 Agau shares reinforces this conclusion. Saleable assets ... less liabilities ... yielded an equity totaling about $113,000. On this basis, the 800,000 shares, which when issued represented a 28.6% interest in the corporation, thus had a value of about $32,000. In this sense, Agau paid little; but USAC's book position was no better, with assets and liabilities about equal. This comparison, however, is likewise unrealistic for it ignores the true value of USAC's most valuable asset, the antimony properties themselves .... In late 1969 or early 1970, ... USAC received two offers ... of $200,000 for a 50% interest .... Further, Lawrence, a qualified expert, testified that in his opinion, the properties had a net value of between 3.5-7.0 million dollars as of August 31, 1970.

\textit{Id.} (footnote omitted).

\textsuperscript{161}The court concluded that this valuation method "present[ed] a clearer and more realistic picture not only of what Agau gave up, but of what it received." \textit{Id.}

Agau was organized solely for the purpose of developing and exploring certain properties for potentially mineable gold and silver ore. The bulk of its cash ... had been expanded in ... exploration of the properties which failed to establish a commercial ore body .... [P]lans for further development had been temporarily abandoned as being economically unfeasible due to Agau's lack of sufficient funds .... Thus, ... had the option not been exercised, Agau might well have gone out of business.

By comparison, ... USAC ... could reasonably be expected to produce substantial profits.

... [A]n independent geologist ... projected ... a three-year net pre-tax profit of $660,000. after deducting all costs .... Without allowing for capital return and exploration and development costs, he projected a three-year profit of $1,357,500. ... Likewise, a metallurgy report by defendant Snyder, projected a sizeable positive cash flow ....

\textit{Id.} at 223-24.

\textsuperscript{162}\textit{Id.} at 224.