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THE CORPORATE OPPORTUNITY DOCTRINE

James C. Slaughter

I. INTRODUCTION

More and more frequently the modern businessman is a member of two or more business organizations engaged in the same type of business. For example, he may be an officer of an investment corporation as well as a member of a partnership interested in the same type of investments. If a profitable business opportunity arises, he faces the problem of whether to acquire it for the corporation, for the partnership, or for himself personally.

Fiduciary principles forbid directors and officers of a corporation, as insiders, from utilizing their strategic positions for private benefit to the detriment of the corporation.¹ If a business opportunity arises that should be acquired for the corporation, it is called a "corporate opportunity."² If diverted by an insider, the opportunity is subject to a constructive trust for the benefit of the corporation.³ A statement of the rule is simple; the difficulty arises in determining whether a business opportunity is also a corporate opportunity.

*Guth v. Loft*⁴ is a leading case in the area of corporate opportunities. In this case, the court noted:

It is true that when a business opportunity comes to a corporate officer or director in his individual capacity rather than in his official capacity, and the opportunity is one which, because of the nature of the enterprise, is not essential to his corporation, and is one in which it has no interest or expectancy, the officer or director is entitled to treat the opportunity as his own, and the corporation has no interest in it, if, of course, the officer or director has not wrongfully embarked the corporation's resources therein. . . .

On the other hand, it is equally true that, 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,

¹ *Pepper v. Litton*, 308 U.S. 295 (1939); *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Durfee v. Durfee & Canning, Inc.*, 323 Mass. 187, 80 N.E.2d 522 (1948).

² *Guth v. Loft*, *supra* note 1; *Durfee v. Durfee & Canning, Inc.*, *supra* note 1; *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913 (1944); *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944).

³ *New v. New*, 148 Cal. App. 2d 372, 306 P.2d 987 (Dist. Ct. App. 1957); *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Durfee v. Durfee & Canning, Inc.*, 323 Mass. 187, 80 N.E.2d 522 (1948).

⁴ 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939), noted in 13 Temp. L.Q. 534 (1939).

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.⁵

The court then stated that the existence of a corporate opportunity depends on whether there is a specific duty on the part of an officer to act in regard to the particular matter as the representative of the corporation, a fact determination. Despite the language of the *Guth* case, at least three tests for determining the existence of a corporate opportunity have been propounded at various times.⁶

The "expectancy test" stands for the proposition that the existence of a corporate opportunity is limited to (1) property in which the corporation has either an existing interest or an expectancy growing out of an existing right or (2) situations in which interference by a director or officer will in some degree frustrate the corporation in effecting the purpose of its creation.⁷ Although many courts have purported to use this test,⁸ it is difficult to ascertain its exact breadth of application. The "expectancy" spoken of in the first part is a right which by its nature is inchoate⁹ and, therefore, involves property in which the corporation has an imperfect right. In the second part such terms as "director interference" and "frustration of corporate purpose" have proved to be ambiguous.¹⁰

⁵ *Id.* at 510-11.

⁶ A fourth approach has been suggested in Carrington & McElroy, *The Doctrine of Corporate Opportunity as Applied to Officers, Directors and Stockholders of Corporations*, 14 Bus. Law. 957 (1959). In many cases, the use of the corporate opportunity doctrine is unnecessary since the same results could be obtained by reference to elementary and long established rules of agency and trust to which officers and directors of corporations are subjected by virtue of their duty of loyalty.

⁷ *Austrian v. Williams*, 103 F. Supp. 64 (S.D.N.Y.), *rev'd on other grounds*, 198 F.2d 697 (2d Cir. 1952); *Colorado & Utah Coal Co. v. Harris*, 97 Colo. 309, 49 P.2d 429 (1935); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913 (1944); *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933); *Washer v. Seager*, 272 App. Div. 297, 71 N.Y.S.2d 46 (Sup. Ct. 1947); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944).

⁸ *Ibid.*

⁹ See *Colorado & Utah Coal Co. v. Harris*, 97 Colo. 309, 49 P.2d 429 (1935); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Solimine v. Hollander*, 128 N.J. Eq. 228, 16 A.2d 203 (Ch. 1940); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944); *cf. McCourt v. Singers-Bigger*, 145 Fed. 103 (8th Cir. 1906); *Pike's Peak Co. v. Pfunter*, 158 Mich. 412, 413 N.W. 19 (1909); see also Fuller, *Restrictions Imposed by the Directorship Status on the Personal Business Activities of Directors*, 26 Wash. U.L.Q. 189, 192 (1941).

In *Westerly Theatre Operating Co. v. Pouzzner*, 162 F.2d 821 (1st Cir. 1947), a corporation was held to have been deprived of a corporate opportunity. A director, the original lessee of property which he had sublet to the corporation, had renewed his lease but had refused to renew the sublease to the corporation.

¹⁰ *Carper v. Frost Oil Co.*, 72 Colo. 345, 211 Pac. 370 (1922); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Pioneer Oil & Gas Co. v. Anderson*, 168

A second method for determining the existence of a corporate opportunity is the "line of business test."¹¹ This test provides that a corporation is deprived of an opportunity whenever an insider engages in a business closely associated with the *existing* or *prospective* activities of his corporation, even though the activity is not unfair to his corporation.

Under the third method, the "fairness test," determination of the existence of a corporate opportunity requires an application of ethical standards of fairness to facts.¹² There is no general rule to cover all situations; the test is applied to the facts and circumstances existing at the time the officer or director appropriated the opportunity.¹³

Considerable objection has been made to the "expectancy test" on grounds that it is unduly narrow and vague.¹⁴ Most cases ostensibly enunciating the first part of the "expectancy test"; *i.e.*, that the opportunity must be property in which the corporation has an interest or tangible expectancy; actually followed the "fairness test" because they weighed the various facts and decided what was fair under the circumstances.¹⁵ The second part of the "expectancy test," which limits (in the absence of a property interest or expectancy) a corporate opportunity to situations in which the opportunity is necessary for the continued existence or prosperity of the corporation, is definitely too restrictive in the light of many cases which hold that a possibility

Miss. 334, 151 So. 161 (1933); *Nebraska Power Co. v. Koenig*, 93 Neb. 39, 139 N.W. 839 (1913); *Gauger v. Hintz*, 262 Wis. 333, 55 N.W.2d 426 (1953); Note, *Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities, or Engaging in a Competing Business*, 39 Colum. L. Rev. 219, 223 (1939).

¹¹ Some basis for the "line of business test" is found in *Turner v. American Metal Co.*, 268 App. Div. 239, 50 N.Y.S.2d 800 (Sup. Ct. 1944). The court states that in cases in which the corporate opportunity doctrine had been applied, the object of the opportunity has had the inherent aptitude of being integrated into the then existing business of the corporation. See also Comment, 74 Harv. L. Rev. 765 (1961).

¹² Ballantine, *Corporations* § 79 (rev. ed. 1946); Fuller, *supra* note 9; Scott, *The Fiduciary Principle*, 37 Calif. L. Rev. 539, 551 (1949); Comment, *Liability of Directors and Other Officers for Usurpation of Corporate Opportunities*, 26 Fordham L. Rev. 528 (1957); Note, 31 N.Y.U.L. Rev. 403 (1956).

¹³ *Kahn v. Schiff*, 105 F. Supp. 973 (S.D. Ohio 1952); *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944); *Turner v. American Metal Co.*, 268 App. Div. 239, 50 N.Y.S.2d 800 (Sup. Ct. 1944); *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940); *Gottlieb v. Mead Corp.*, 137 N.E.2d 178 (Ohio C.P. 1954).

¹⁴ *E.g.*, see Fuller, *supra* note 9; Scott, *supra* note 12; Comment, 26 Fordham L. Rev. 528, 529 (1957).

¹⁵ See *Largarde v. Anniston Lime & Stone Co.*, 126 Ala. 496, 28 So. 199 (1900); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933). The courts in the above cases merely examined the various factors present, decided that fairness required a certain conclusion, and explained their decisions by using expectancy and property interest labels. *Accord*, *Kaufman v. Wolfson*, 153 F. Supp. 253 (S.D.N.Y. 1957); *Johnston v. Greene*, 121 A.2d 919 (Del. Sup. Ct. 1956); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944); *Gauger v. Hintz*, 262 Wis. 333, 55 N.W.2d 426 (1953).

of harm to the corporation need not be present for the corporate opportunity doctrine to apply.¹⁶

Two cases have specifically disapproved the "expectancy test." In *Rosenblum v. Judson Engineering Corp.*,¹⁷ the court stated that although a corporation had no present interest or expectancy in the acquisition of the new business and it was not essential to the corporation's present needs, the directors might still be liable. In *Durfee v. Durfee & Canning, Inc.*,¹⁸ the court stated that the test was not whether the corporation has an existing interest or an expectancy in the property involved, but whether, in the particular circumstances, the acquisition of the opportunity by an insider would be unfair. Such unfairness was to be determined by an application of ethical standards to the facts. This case, however, may be authority in only a limited situation because the court, with respect to the test employed, drew a distinction between *Durfee*, in which the insider attempted to resell the opportunity to his corporation at a profit, and *Lincoln Stores, Inc. v. Grant*,¹⁹ in which no such attempt was made.

Although *Durfee* may be viewed as limiting the application of the "fairness test" to resale situations, many other cases have not been so restrictive.²⁰ Moreover, in *American Investment Co. v. Lichtenstein*,²¹ the court stated that the true basis for the decision in *Durfee* was not an expectancy or property interest, but the unfairness of the fiduciary taking advantage of an opportunity if the interests of his corporation justly call for protection. The court went even further and construed the decision in *Guth v. Loft*²² as supporting the "fairness test." Therefore, it appears that the "fairness test" has been used in the more recent cases to determine the applicability of the corporate opportunity doctrine.²³

¹⁶ These cases, in effect, state that the corporate opportunity doctrine does not rest upon the narrow ground of damage to the corporation, but upon the broad foundation of public policy which, for the purpose of removing temptation, denies to an insider unjustly gained enrichment. See *Pergament v. Frazier*, 93 F. Supp. 13 (E.D. Mich. 1950); *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Durfee v. Durfee & Canning, Inc.*, 323 Mass. 187, 80 N.E.2d 522 (1948); *Knox Glass Bottle Co. v. Underwood*, 228 Miss. 699, 89 So. 2d 799 (1956); *Weissman v. A. Weissman, Inc.*, 382 Pa. 189, 114 A.2d 797 (1955); *Lutherland, Inc. v. Dahlen*, 357 Pa. 143, 53 A.2d 143 (1947).

¹⁷ 99 N.H. 267, 109 A.2d 558 (1954).

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

¹⁹ 309 Mass. 417, 34 N.E.2d 704 (1941).

²⁰ *Presidio Mining Co. v. Overton*, 261 Fed. 933 (9th Cir. 1919); *Industrial Indem. Co. v. Golden State Co.*, 117 Colo. App. 2d 519, 256 P.2d 677 (1953); *Rosenblum v. Judson Eng'r Corp.*, 99 N.H. 267, 109 A.2d 558 (1954); *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

²¹ 134 F. Supp. 857 (D. Mo. 1955).

²² See note 4 *supra*.

²³ *International Bankers Life Ins. Co. v. Holloway*, — Tex. —, 368 S.W.2d 567 (1963), definitely established that Texas follows the fairness test.

II. CIRCUMSTANCES AFFECTING THE LIABILITY OF OFFICERS AND DIRECTORS

Although the facts of each particular case determine whether an insider has taken advantage of a corporate opportunity, there are, nevertheless, recurring circumstances of which the courts continually take notice.

A. Inability Of The Corporation To Avail Itself Of The Opportunity

An insider may take advantage of a *business* opportunity when his corporation is definitely unable to do so. Such a situation is not a *corporate* opportunity. Therefore, the presence of this factor alone prevents the application of the doctrine and its constructive trust remedy.²⁴ The inability may be due to many reasons, including financial.²⁵ There is a split of authority on what constitutes such

²⁴ In Texas, however, such may not be the case, for the Texas Supreme Court in *International Bankers Life Ins. Co. v. Holloway*, *supra* note 23, appears to have held that the inability of the corporation to avail itself of an opportunity is just one factor to be used in determining fairness.

²⁵ A corporation may be unable to take advantage of an opportunity for reasons other than financial. Among these are:

(1) Legal barriers preventing the corporation from taking advantage of an opportunity. *Urban J. Alexander Co. v. Trinkel*, 311 Ky. 635, 224 S.W.2d 923 (1949); *Jasper Appalachian Gas Co.*, 152 Ky. 68, 153 S.W. 50 (1913); *Thilco Timber Co. v. Sawyer*, 236 Mich. 401, 210 N.W. 204 (1926); *Electric Dev. Co. v. Robson*, 140 Neb. 526, 28 N.W.2d 130 (1947).

(2) Settled policy of the corporation not to engage in a particular line of business. *Urban J. Alexander Co. v. Trinkel*, *supra*; *Lancaster Loose Leaf Tobacco Co. v. Robinson*, 152 Ky. 68, 250 S.W. 997 (1923); *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933); *Gauger v. Hintz*, 262 Wis. 333, 55 N.W.2d 426 (1953); *Bump Pump Co. v. Waukesha Foundry Co.*, 238 Wis. 643, 300 N.W. 500 (1941).

(3) Transactions beyond the powers of the corporation. Here the primary purpose of the corporation controls rather than the wide powers and purposes conferred on it by its charter. *Barr v. Pittsburgh Plate Glass Co.*, 57 Fed. 86 (3d Cir. 1893); *Urban J. Alexander Co. v. Trinkel*, *supra*; *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913 (1944); *Greer v. Stannard*, 85 Mont. 78, 277 Pac. 622 (1929).

(4) Refusal of the party disposing of the opportunity to deal with the corporation. *Bisbee v. Midland Linseed Prod. Co.*, 19 F.2d 24 (8th Cir. 1927); *Urban J. Alexander Co. v. Trinkel*, *supra*; *Pioneer Oil & Gas Co. v. Anderson*, *supra*; *Washer v. Seager*, 272 App. Div. 297, 71 N.Y.S.2d 46 (Sup. Ct. 1947); *Hauben v. Morris*, 255 App. Div. 35, 5 N.Y.S.2d 721 (Sup. Ct. 1938).

(5) Unsuccessful attempts by the corporation to obtain the opportunity. *Du Pont v. Du Pont*, 256 Fed. 129 (3d Cir. 1919); *Urban J. Alexander Co. v. Trinkel*, *supra*; *Seal-O-Matic Mach. Mfg. Co. v. C. & M. Eng'r & Mfg., Inc.*, 21 N.J. Super. 311, 91 A.2d 173 (Ch. 1952). An unusual case on the liability of an insider when a corporation is unable to avail itself of a corporate opportunity is *Young v. Columbia Oil Co.*, 110 W. Va. 364, 158 S.E. 678 (1931). Directors who explored and secured oil lands near their corporation's developed property were held accountable as fiduciaries for failing to offer the opportunity to the other shareholders even though the corporation itself was legally unable to take advantage of the opportunity. However, this is an unusual case, and the corporate opportunity doctrine does not require an officer or director to share the opportunity with other shareholders when his corporation is unable to avail itself of the opportunity. *Young* has been interpreted as holding that the opportunity must be shared with the shareholders not because of a deprivation of a corporate opportunity, but because of the unusual circumstances that the information about

financial inability. Many cases have held that if a corporation, though solvent, lacks the financial resources to take advantage of the opportunity, its directors and officers may take the opportunity for themselves.²⁸ Other cases, however, have said that mere lack of financial resources is not sufficient. *Irving Trust v. Deutsch*²⁷ stated:

If directors are permitted to justify their conduct on such a theory [that the corporation is unable to undertake the venture] 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 for profit will be open to them personally. . . . Nevertheless, [the facts] tend to show the wisdom of a rigid rule forbidding the directors of a solvent corporation to take over for their own profit a corporate contract on the plea of the corporation's financial inability to perform.²⁸

Whether all courts will feel impelled to adopt such a rule of uncompromising rigidity is doubtful. Regardless of which view of financial inability is followed, it is held universally that an insider has no specific duty to use or to loan his own personal funds to assist the corporation in meeting its financial obligation or to enable it to take advantage of a business opportunity.²⁹ Nonetheless, the inability of a corporation because of a lack of funds may not be relied upon by its directors if their own lack of diligence was responsible for the corporation's momentary fiscal condition.³⁰

B. Business Similar To Or Competitive With That Of The Corporation

A director or officer may, without liability, engage in a business activity similar to or closely associated with the business of his corporation so long as he acts in good faith and does not harm his corporation.³¹ Good faith competition does not of itself give rise to the

and authority to drill wells on the oil lands were given to the directors specifically for corporate purposes. See Note, *Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities or Engaging in a Competing Business*, 39 Colum. L. Rev. 219 (1939).

²⁶ *Presidio Mining Co. v. Overton*, 261 Fed. 933 (9th Cir. 1919); *Urban J. Alexander Co. v. Trinkel*, *supra* note 25; *Hannerty v. Standard Theatre Co.*, 109 Mo. 397, 19 S.W. 82 (1892); *Hauben v. Morris*, *supra* note 25; *Green v. Hall*, 228 S.W. 183 (Tex. Comm. App. 1921); *Gauger v. Hintz*, *supra* note 25.

²⁷ 73 F.2d 121 (2d Cir. 1934).

²⁸ *Id.* at 124. *Accord*, *Electric Dev. Co. v. Robson*, 140 Neb. 526, 28 N.W.2d 130 (1947).

²⁹ *Urban J. Alexander Co. v. Trinkel*, 311 Ky. 635, 224 S.W.2d 923 (1949); *Hart v. Bell*, 222 Minn. 69, 23 N.W.2d 375 (1946), noted in 2 U. Chi. L. Rev. 323 (1935); *Green v. Hall*, 228 S.W. 183 (Tex. Comm. App. 1921).

³⁰ *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 127 A.2d 885 (Ch. 1956).

³¹ *Red Top Cab Co. v. Hanchett*, 48 F.2d 236 (N.D. Colo. 1931); *American Inv. Co. v. Lichtenstein*, 134 F. Supp. 857 (E.D. Mo. 1955); *McKinistry v. Thomas*, 258 Ala. 690, 64 So. 2d 808 (1953); *Raines v. Toney*, 228 Ark. 1170, 313 S.W.2d 802 (1958); *New v. New*, 148 Colo. App. 2d 372, 306 P.2d 987 (1957); *Industrial Indem. Co. v. Golden State Co.*, 117 Colo. App. 2d 519, 256 P.2d 677 (1953); *Hall v. Dekker*, 45 Colo. App. 2d 783, 115 P.2d 15 (1941); *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Urban J. Alexander Co. v. Trinkel*, 311 Ky. 635, 224 S.W.2d 923 (1949); *Coleman v. Hanger*, 210

corporate opportunity doctrine and is of very little weight in the equitable balancing process of the "fairness test."

C. Prior Negotiations By The Corporation For The Opportunity

Will the fact that an insider personally acquired an opportunity for which his corporation had been negotiating invoke the doctrine? In *De Bardeleben v. Bessemer Land & Improvement Co.*,³² the president of a corporation spent a large amount of the corporation's money in prospecting and exploring coal land and in acquiring leases on the land. He then took one of the leases in his own name. The court applied the corporate opportunity doctrine in this case, but the decision was based on the spending of corporate funds, not the fact of negotiations.

In *Pioneer Oil & Gas Co. v. Anderson*,³³ a corporation was negotiating for the purchase of certain properties which its officers later acquired for themselves. The court said that the fact of negotiations by the corporation was not sufficient to cause the corporate opportunity doctrine to apply, particularly since other factors demonstrating the fairness of the acquisition by the officers were present. In *Colorado & Utah Coal Co. v. Harris*,³⁴ the court refused to apply the corporate opportunity doctrine, even though negotiations for the opportunity by the corporation had occurred, because other factors outweighed the negotiations. Furthermore, in *Beatty v. Guggenheim Exploration Co.*,³⁵ the court held that an officer who was sent by the corporation to determine the advisability of purchasing a business opportunity was not barred from acquiring it for himself at a later date by that fact alone. The result of these cases is that negotiation by the corporation for an opportunity acquired by insiders will not in itself cause the doctrine to apply. The case against an insider is, however, stronger if negotiation is present.

Ky. 309, 275 S.W. 784 (1925); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Greer v. Stannard*, 85 Mont. 78, 277 Pac. 622 (1929). *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933), states that no problem arises over a director or officer competing with his corporation when he has previously reserved a personal right to engage in transactions in which his corporation would normally be interested. A more restrictive view is set forth in *Fuller*, *supra* note 9, at 209. He states that some limitation exists where a director of one corporation desires to become affiliated in a managerial or directoral position with an already organized, competitive corporation; the reason is that if a director is allowed to affiliate in such a manner, the director would be in the impossible position of impartially serving two masters with diametrically opposed interests. Such an affiliation is proper if a majority of the shareholders of his corporation consent to the director's action by re-electing him as a director with knowledge of his connection with their corporation's competitor.

³² 140 Ala. 621, 37 So. 511 (1904).

³³ 168 Miss. 334, 151 So. 161 (1933).

³⁴ 97 Colo. 309, 49 P.2d 429 (1935).

³⁵ 167 App. Div. 864, 153 N.Y.S. 757 (Sup. Ct. 1915).

*D. Opportunity Extended To The Corporation Or To Insider
Ostensibly Acting For The Corporation*

Although negotiation by the corporation is not sufficient to cause a corporate opportunity to arise, if an officer or director personally acquires an opportunity while ostensibly negotiating or acquiring the opportunity for his corporation, a different result will occur. An officer or director cannot divert to his own favor the benefit of an opportunity extended to the corporation directly³⁶ or to him as a fiduciary of his corporation.³⁷ The court, in *Litwin v. Allen*,³⁸ stated that this latter circumstance imposes a mandate to buy for the corporation.³⁹ Several other cases have placed liability on a director or officer for taking an opportunity for himself while representing that he was acting for his corporation.⁴⁰ In addition, liability may be found even if an opportunity is offered to a director or officer in his *individual* capacity when other factors indicating deprivation of a corporate opportunity are present.⁴¹

*E. Knowledge Of The Opportunity By Virtue Of The
Corporate Fiduciary Position*

*Litwin v. Allen*⁴² stated that an insider acquires for the benefit of the corporation if he takes an opportunity which he discovered through the corporation and which the corporation had contemplated and desired.⁴³ There were other factors in the case weighing strongly in favor of application of the doctrine, however, and other cases have followed a less rigid rule.⁴⁴ *Colorado & Utah Coal Co. v. Harris*⁴⁵

³⁶ *Pioneer Oil & Gas Co. v. Anderson*, 168 Miss. 334, 151 So. 161 (1933). See also *Albert H. Volk Co. v. Fleschner Bros. Inc.*, 298 App. Div. 717, 60 N.Y.S.2d 244 (Sup. Ct. 1945). *Accord*, *Chicago Flexolite Floor Co. v. Lane*, 188 Minn. 422, 247 N.W. 517 (1933).

³⁷ *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

³⁸ *Ibid.*

³⁹ The mandate may also arise by the fact that a director or officer had undertaken to negotiate in the field on behalf of the corporation. *Ibid.*

⁴⁰ *Central Railroad Signal Co. v. Langden*, 194 F.2d 310 (7th Cir. 1952); *Melgard v. Moscow Idaho Seed Co.*, 73 Idaho 265, 251 P.2d 546 (1952).

⁴¹ *Austrian v. Williams*, 103 F. Supp. 64 (S.D.N.Y.), *rev'd on other grounds*, 198 F.2d 697 (2d Cir. 1952); *Greene v. Allen*, 114 A.2d 916 (Del. Ch. 1955); *Gottlieb v. McKee*, 107 A.2d 240 (Del. Ch. 1954); *Rosenblum v. Judson Eng'r Corp.*, 99 N.H. 267, 109 A.2d 558 (1954); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944).

⁴² 25 N.Y.S.2d 667 (Sup. Ct. 1940).

⁴³ The same result occurred in *Tierney v. United Pocohontas Coal Co.*, 85 W. Va. 545, 102 S.E. 249 (1920).

⁴⁴ In *Nebraska Power Co. v. Koenig*, 93 Neb. 39, 139 N.W. 839 (1913), the court came close to deciding that a corporate opportunity was created by the acquisition of knowledge of the opportunity through being a director. But there were also the additional important factors that the corporation had expended considerable money in securing the knowledge and that, if the director were allowed to take the opportunity, his corporation's investment would be destroyed.

⁴⁵ 97 Colo. 309, 49 P.2d 429 (1935).

and *Diedrick v. Helm*⁴⁶ demonstrate that if other factors are not present mere knowledge of an opportunity by an insider through his corporate position will not invoke the doctrine.⁴⁷

F. Disclosure Of The Opportunity To The Corporation

Affirmative disclosure to the corporation before acquisition for himself is an important factor in freeing an insider from liability.⁴⁸ On the other hand, *failure to disclose*, although not conclusive, is said to be an extremely significant factor in establishing liability under the corporate opportunity doctrine.⁴⁹ It appears wise, therefore, for an insider to disclose the business opportunity to his corporation before acquiring it personally if such acquisition raises the slightest inference of a corporate opportunity.

G. Rejection Of The Opportunity By The Corporation

If a corporation, through a disinterested or nondominated board of directors, refuses to take a business opportunity, the officers and directors may take it.⁵⁰ Rejection is no defense, of course, if it is induced by fraud or misrepresentation.⁵¹ Furthermore, in a domination situation, whether or not the board has a nondominated minority can be of significance. Although the cases provide no clear answer, the following theories are submitted for use if a nondominated minority can be identified:

(1) If the minority constitutes a substantial portion of the board (*i.e.*, one-third) and unanimously joins in the vote to release the corporation's prior claim to the opportunity, either of two rules reasonably might be followed:

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

⁴⁷ See also *Melgard v. Moscow Idaho Seed Co.*, 73 Idaho 265, 251 P.2d 546 (1952), and *Pikes Peak Co. v. Pfunter*, 158 Mich. 412, 123 N.W. 19 (1909). The same view is set forth in Note, *Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities, or Engaging in a Competing Business*, 39 Colum. L. Rev. 219 (1939).

⁴⁸ *Mayflower Hotel Stock Protective Comm. v. Mayflower Hotel Corp.*, 193 F.2d 666 (D.C. Cir. 1951); *Columbus Outdoor Advertising Co. v. Harris*, 127 F.2d 38 (6th Cir. 1942); *Cowell v. McMillan*, 177 Fed. 25 (9th Cir. 1910); *Paddock v. Simoneit*, 147 Tex. 571, 218 S.W.2d 428 (1949).

⁴⁹ *Loewer v. Lonoke Rice Milling Co.*, 111 Ark. 62, 161 S.W. 1042 (1913), held that an officer-director had no right to set up an interest in a purchase antagonistic to the corporation nor to make a profit on it for himself without the knowledge and consent of the other directors. See also *Central Railroad Signal Co. v. Longden*, 194 F.2d 310 (7th Cir. 1952); *Farwell v. Pyle-National Headlight Co.*, 289 Ill. 157, 124 N.W. 449 (1919); *Production Mach. Co. v. Howe*, 327 Mass. 372, 99 N.E.2d 32 (1951); *Kelley v. 74 & 76 West Tremont Ave. Corp.*, 4 Misc. 2d 533, 151 N.Y.S.2d 900 (Sup. Ct. 1956).

⁵⁰ *Cowell v. McMillan*, 177 Fed. 25 (9th Cir. 1910); *Barr v. Pittsburg Plate Glass Co.*, 57 Fed. 86 (3d Cir. 1893); *Loewer v. Lonoke Rice Milling Co.*, 111 Ark. 62, 161 S.W. 1042 (1913); *McKee v. Brazell*, 99 Okla. 36, 225 Pac. 520 (1924); Comment, 74 Harv. L. Rev. 765 (1961).

⁵¹ *Kelley v. 74 & 76 West Tremont Ave. Corp.*, 4 Misc. 2d 533, 151 N.Y.S.2d 900 (Sup. Ct. 1956).

(a) The minority's concurrence is a sufficient guarantee that good faith business judgment has been exercised.

(b) The insider has no absolute defense, but anyone alleging improper appropriation has the burden of proving that the board acted in bad faith.

(2) If the nondominated minority is unsubstantial or is not unanimous for release, the presumption of good faith disappears, and the dominating officer or director would have the burden of showing good faith rejection by the board.

As mentioned above, these theories are not established by case authority. The only case in this area is *Greene v. Allen*,⁵² in which a stockholder brought a derivative action against the corporation and its president, Odlum, (who was also a director and substantial stockholder) for an accounting by him of profits realized through his purchase of certain patents that were previously rejected by the corporation. The evidence showed that Odlum dominated the board of directors. The court held that if an opportunity comes to a corporation and it is rejected for "business judgment" reasons, a person in Odlum's fiduciary relationship to a corporation is disqualified from taking it for himself. Otherwise those to whom the fiduciary duty is owed would very seldom be able to prove bad faith because "business judgment" is essentially a subjective evaluation by the directors.

*Greene v. Allen*⁵³ appears to establish the following rules for a situation in which there is no substantial, unanimous nondominated minority present:

(1) If a dominated board rejects the opportunity through the exercise of "business judgment" (*i.e.*, a rejection for reasons other than inability of the corporation to acquire the opportunity) the dominating individual normally cannot take the opportunity. However, another insider would probably be allowed to take it.⁵⁴

⁵² 114 A.2d 916 (Del. Ch. 1955). An earlier case, *Turner v. American Metal Co.*, 268 App. Div. 239, 50 N.Y.S.2d 800 (Sup. Ct. 1944), briefly discussed a "business judgment" rejection. A large percentage of a speculative mining venture was acquired by directors after rejecting the possibility of acquiring all but seven per cent of it for their corporation. The court held that because of the highly speculative nature of the venture the directors had exercised honest "business judgment" in their decision and, therefore, were entitled to acquire the venture for themselves. The board of directors in this case, however, was not dominated, and the court specifically mentions that it was disinterested; therefore, the case is not in conflict with *Greene v. Allen*. It is puzzling, however, that the court considered the board of directors disinterested in light of the fact that they personally acquired the opportunity after rejecting most of it for their corporation.

⁵³ 114 A.2d 916 (Del. Ch. 1955), noted in 44 Geo. L.J. 526 (1956); 54 Mich. L. Rev. 561 (1956) (critical of case); 31 N.Y.U.L. Rev. 403 (1956); 28 Rocky Mt. L. Rev. 419 (1956); 24 U. Cinc. L. Rev. 588 (1955); 104 U. Pa. L. Rev. 424 (1955) (critical of case).

⁵⁴ When a dominated board of directors rejects an opportunity in the exercise of business judgment, the question remains whether *Greene v. Allen* holds that only the dominating

(2) If the dominating individual sustains the burden of proving that the directors acted in good faith in the rejection, there is a strong possibility that he will be allowed to acquire the opportunity.⁵⁵

(3) If rejection is for a reason other than exercise of business judgment, *e.g.*, illegality, financial inability, etc., the dominating individual will be allowed to take the opportunity.

H. Use Of Corporate Facilities By An Insider To Acquire The Opportunity

It has been said that use of any corporate facility—including funds, credit, property, or information gained through insider status—causes the corporate opportunity doctrine to apply.⁵⁶ The corporation, having become involved in the venture, is said to have the right to any benefit resulting from such a transaction. Another position has been taken, however, that if the corporate facilities involved are minor, the use of them is inconclusive evidence of a corporate opportunity situation.⁵⁷ The corporation may be unaware of the existence of the opportunity, disinterested in it at the time it arises, or involved only to the slightest extent; or the opportunity may be wholly unrelated to the corporation's business. Under these circumstances it may not be unfair to allow an insider to take the opportunity.

If there is an unauthorized use of corporate funds or corporate credit by an insider to acquire or develop an opportunity, this fact alone invokes the corporate opportunity doctrine, even though the funds were employed in a manner unavailable to the corporation.⁵⁸ The insider must account to the corporation for all profits, regardless of how disproportionate they may be to the amount of corporate funds used.⁵⁹ This is the general rule for misuse of funds by a trus-

insider cannot take the opportunity or that no fiduciary may take the opportunity. It seems that the court intended the holding to apply only to individuals who control the board, for the court speaks of "a person in Odium's fiduciary relationship" and states that "at least in this limited situation . . ." the rule applies.

⁵⁵ Dictum in the case appears to modify the rule that a dominating insider cannot take an opportunity rejected for "business judgment" reasons to allow the dominating individual a defense if he can prove good faith rejection. The court raised this question, but then disposed of it by saying that Odium failed to sustain the burden of proving good faith.

⁵⁶ Comment, 26 *Fordham L. Rev.* 528 (1957).

⁵⁷ Note, *Liability of Directors for Taking Corporate Opportunities, Using Corporate Facilities, or Engaging in a Competing Business*, 39 *Colum. L. Rev.* 219, 227-30 (1939). This position was based on the expectancy test. However, it would be sound even under the fairness test.

⁵⁸ *Backus v. Finkelstein*, 23 F.2d 357 (D. Minn. 1927), *appeal dismissed*, 31 F.2d 1011 (8th Cir. 1929); *De Bardeleben v. Bessemer Land & Improvement Co.*, 140 Ala. 621, 37 So. 511 (1904); *Johnston v. Greene*, 33 Del. Ch. 508, 121 A.2d 919 (Eq. 1956); *Bromschwig v. Carthage Marble & White Lime Co.*, 334 Mo. 319, 66 S.W.2d 889 (1933); *Gilmore v. Gilmore Drug Co.*, 279 Pa. 193, 123 Atl. 730 (1924); *Hazard v. Durant*, 14 R.I. 25 (1882); *Sparks v. McCraw*, 112 S.C. 519, 100 S.E. 161 (1919).

⁵⁹ *Backus v. Finkelstein*, *supra* note 58; *Bromschwig v. Carthage Marble & White Lime Co.*, *supra* note 58; *Sparks v. McCraw*, *supra* note 58.

tee.⁶⁰ The insider may, however, in the absence of fraud or statutory prohibition, borrow funds from his corporation with which to purchase a business opportunity, and the fact of borrowing would probably be of little weight in a court's determination of whether to apply the doctrine.⁶¹ On the other hand, if an insider obtains corporate funds without being obligated to furnish security and pay interest, then the opportunity is said to be held in constructive trust for the corporation by virtue of the doctrine.⁶²

I. *Acquisition By An Insider Of Stock In His Own Corporation*

The fact that an insider has dealt in or made a profit on the outstanding stock of his corporation normally will not give rise to the corporate opportunity doctrine. An insider has the right to buy and sell the stock unless facts exist that make the transaction inequitable against the corporation or the other shareholders.⁶³ For instance, the Texas Supreme Court recently found a deprivation of corporate opportunity in a situation in which insiders sold their previously acquired stock in their corporation in competition with the sale by their corporation of newly authorized stock.⁶⁴

An interesting example of an equitable purchase of stock of their own corporation by directors was presented in *Hauben v. Morris*.⁶⁵ Several directors of a corporation bought its outstanding stock and later resold it to the corporation at a profit. At the time of the directors' purchase, the corporation was not negotiating for the purchase of the stock, was not seeking to reduce its capital stock, and lacked sufficient assets to make the purchase itself. The court held that there was no mandate on the directors to buy the stock for their corporation. In *Adams v. Midwest Chevrolet Corp.*,⁶⁶ a stockholder offered

⁶⁰ See note 57 *supra*.

⁶¹ *Paddock v. Simoneit*, 147 Tex. 571, 218 S.W.2d 428 (1949). An important factor in this case, however, was that the stockholders and principal creditors of the corporation knew of and approved the loan.

⁶² *Upton v. Otis*, 155 F.2d 606 (2d Cir. 1946).

⁶³ *Bisbee v. Midland Linseed Prod. Co.*, 19 F.2d 24 (8th Cir. 1927); *Du Pont v. Du Pont*, 256 Fed. 129 (3d Cir. 1919); *Lewin v. New York Ambassador, Inc.*, 61 N.Y.S.2d 492 (Sup. Ct. 1946), *aff'd*, 271 App. Div. 927, 67 N.Y.S.2d 706 (App. T. 1947); *Hauben v. Morris*, 255 App. Div. 35, 5 N.Y.S.2d 721 (Sup. Ct. 1938); *Adams v. Mid-West Chevrolet Corp.*, 198 Okla. 461, 179 P.2d 147 (1946). In *Bisbee*, the court mentioned fact situations of this nature, e.g., when a director or officer has been employed by the corporation to buy the stock for it, or when he has made a wrongful use of his position or influence or the money, property or credit of his corporation to acquire stock which the corporation desires to buy for itself. Whether the corporation is desirous of buying its own stock, however, is determined not by the court but by the board of directors of the corporation. Such a situation would also be present where the corporation was attempting to reduce its capital stock.

⁶⁴ *International Bankers Life Ins. Co. v. Holloway*, ___ Tex. ___, 368 S.W.2d 567 (1963).

⁶⁵ 255 App. Div. 35, 5 N.Y.S.2d 721 (Sup. Ct. 1938).

⁶⁶ 198 Okla. 461, 179 P.2d 147 (1946).

to sell the president-director a great amount of stock at a favorable price and on terms for which the stock ordinarily could not be purchased. The president took the opportunity in his individual capacity without disclosure to his corporation, although it was capable of purchasing and its charter contemplated that it might purchase its own stock. The court upheld the president's purchase of the stock.⁶⁷

Allowing an insider to deal in the stock of his corporation without fear of the corporate opportunity doctrine, except in exceptionally inequitable situations, is a sound rule. An insider's duty as trustee with respect to the business and property of his corporation does not extend to its outstanding stock, for the stock is the individual property of the respective stockholders and is not in any sense property of the corporation.⁶⁸ The corporation as such has no interest in the outstanding stock or in dealings between the stockholders with respect to it. Each stockholder has the right to buy stock in the corporation or to sell his stock as he sees fit, and no stockholder or group of stockholders has any pecuniary interest in the stock of others or in any gain or loss that may be realized or sustained by others in dealing with or disposing of their stock.

J. Acquisition By An Insider Of Obligations Owed By His Corporation To Third Persons

A corporate opportunity may arise if an insider acquires claims owed by his own company. Ownership of such obligations could well give rise to a clash between the personal interests of the claimholder and those of the debtor-corporation. For example, in such instances

⁶⁷ The corporate opportunity doctrine was applied in this area in an unusual way in *Dunett v. Arn*, 71 F.2d 912 (10th Cir. 1934). Defendants were officers and controlling stockholders of corporation A. Corporation B desired an oil lease held by corporation A, but A wanted more money for the lease than B was willing to pay. The defendants sold their stock to B and also induced the minority stockholders to sell their stock to B for less than the price received by them, although the minority stockholders were not aware of this. B then owned A and was able to obtain the lease. The court held that under the facts of the case the sale of stock to B was in substance a sale by A of its assets which was a corporate transaction and that an insider may not profit or acquire any personal benefit in a corporate transaction not shared by the other stockholders. The court then stated that a stockholder of a corporation has a right to buy and sell its stock and to keep the profits therefrom, even though he is a managing officer of the corporation, but that officers cannot, under cover of this rule, carry through a transaction such as appears in this case, which is in essence the diversion to themselves of a part of the price corporation B paid for the property of corporation A. The court also stated that there was a conflict of authority in this area of the law. The majority rule, according to the court, is that since dealing in its own stock is not a corporate function, the officers and directors of a corporation do not occupy a fiduciary relationship to the stockholder with respect to his shares in the corporation, whereas the minority rule makes an officer or director a trustee of the individual stockholders with respect to their stock in the corporation. The court did not base its holding on either of these rules, for it stated that the question was not presented in the case.

⁶⁸ *Bisbee v. Midland Linseed Prod. Co.*, 19 F.2d 24 (8th Cir. 1927); *Keely v. Black*, 91 N.J. Eq. 520, 111 Atl. 22 (Ch. 1920); *Adams v. Mid-West Chevrolet Corp.*, 198 Okla. 461, 179 P.2d 147 (1946).

the corporation could buy the obligations before maturity at a discount; however, the insider could allow them to be held to maturity to enforce their payment at full face value. Furthermore, it may be to the corporation's advantage to obtain an extension of the debt at maturity, but an insider who owns such a claim might prefer to press for immediate payment.

1. *Purchase of Claims at Par* Unless the circumstances surrounding the transaction make it inequitable⁶⁹ or unless a statute forbids,⁷⁰ an insider may purchase liquidated obligations of his corporation at par and enforce the same against the corporation to the extent of the money actually paid plus legal interest thereon.⁷¹ He is entitled to enforce the claim according to its tenor even though the opportunity for its acquisition was not first offered to the debtor.⁷² The reason could well be that the director or officer purchasing a company obligation at par obtains no profit at the expense of the debtor when the obligation is paid and that company creditors from whom the purchase was made receive the face amount of their claim. Moreover, the corporation may benefit from such a purchase not only as a result of the additional stake which the director thereby obtains in the business, but also through the obvious advantage accruing from the general public knowledge that corporate insiders have sufficient faith in the corporation's future to put their money into its obligations.

2. *Purchase of Claims Below Par* If the claim was purchased at less than par, a significantly different problem is presented. Some cases strongly indicate that an insider is absolutely precluded from collecting from his company more than he paid for the claim.⁷³ In these cases, the courts use an analogy to trust law which prevents the trustee from profiting from the purchase of trust obligations.⁷⁴ For

⁶⁹ *Martin v. Chambers*, 214 Fed. 769 (5th Cir. 1914); *Bellaire Sec. Corp. v. Brown*, 124 Fla. 47, 168 So. 625, 640 (1936).

⁷⁰ *Weissman v. A. Weissman, Inc.*, 374 Pa. 470, 97 A.2d 870 (1953); *Fowler v. Iowa Land Co.*, 18 S.D. 131, 99 N.W. 1095 (1904).

⁷¹ *Monroe v. Scofield*, 135 F.2d 725 (10th Cir. 1943); *Kroegher v. Calivada Colonization Co.*, 119 Fed. 641 (3d Cir. 1902); *Ripperger v. Allyn*, 25 F. Supp. 554 (S.D.N.Y. 1938); *In re McCrory Stores Corp.*, 12 F. Supp. 267 (S.D.N.Y. 1935); *Solimine v. Hollander*, 128 N.J. Eq. 228, 16 A.2d 203 (Ch. 1940); *Hauben v. Morris*, 255 App. Div. 35, 5 N.Y.S.2d 721 (Sup. Ct. 1938); *Weissman v. A. Weissman, Inc.*, 382 Pa. 189, 114 A.2d 797 (1953).

⁷² *Ibid.*

⁷³ *Martin v. Chambers*, 214 Fed. 769 (5th Cir. 1914); *Davis v. The Rock Creek L.F. & M. Co.*, 55 Cal. 359 (1880); *Bramblet v. Commonwealth Land & Lumber Co.*, 27 Ky. L. Rep. 156, 84 S.W. 545 (Ct. App. 1905); *The Chateau Ins. Co. v. Floyd*, 74 Mo. 286 (1881); *Lingle v. National Ins. Co.*, 45 Mo. 109 (1869); *Brewster v. Stratman*, 4 Mo. App. 41 (1877); *McDonald v. Haughton*, 70 N.C. 393 (1874); *Duncomb v. New York H. & N. Ry.*, 84 N.Y. 190 (1881); *Hill v. Frazier*, 22 Pa. 320 (1853); *Moulton v. Connell-Hall-McLester Co.*, 93 Tenn. 377, 27 S.W. 672 (1894).

⁷⁴ 3 *Fletcher, Private Corporations* 869 (repl. ed. 1947); 1 *Perry, Trusts* 712 (7th ed. 1929); *Fuller, supra* note 9; *Scott, The Trustee's Duty of Loyalty*, 49 *Harv. L. Rev.* 521 (1936).

instance, if an insider purchases a claim against his corporation when it was his express or implied duty to purchase for the corporation (*i.e.*, to pay the claim with corporate funds) then the insider cannot profit by such a purchase.⁷⁵ Furthermore, he may not enforce claims bought at a discount for their face value if such claims were acquired pursuant to a resolution of the board of directors that guaranteed his repayment.⁷⁶ Moreover, he may not require the full face value of such discounted claims if a specific fund for their purchase has been set up by his corporation or a special liquidation has been ordered.⁷⁷ It has also been held that an insider may not profit on such claims if the directors who consented to the purchase intentionally failed to provide the means for the corporation to take care of such claims when it was well able to do so.⁷⁸ In addition, an insider may not take advantage of the corporation during its insolvency by purchasing claims at a discount and enforcing such claims at their full face value.⁷⁹ Of course, if the corporation is unable to make the purchase,⁸⁰ although not insolvent,⁸¹ or if it has decided to do nothing about debt retirement before maturity, the acquisition of the claims below par will be unobjectionable.⁸² Furthermore, in spite of these restrictions, the general rule appears to be that an insider may make a good faith purchase of claims at a discount and enforce them at their face value.⁸³

⁷⁵ *Monroe v. Scofield*, 135 F.2d 725 (10th Cir. 1943); *Mothershead v. Douglas*, 215 Ark. 519, 221 S.W.2d 424 (1949); *Todd v. Temple Hosp. Ass'n*, 96 Cal. App. 42, 273 Pac. 595 (Dist. Ct. App. 1939); *Wabunga Land Co. v. Scheanbeck*, 245 Mich. 505, 222 N.W. 707 (1929); *Weissman v. A. Weissman, Inc.*, 382 Pa. 189, 114 A.2d 797 (1953).

⁷⁶ *Kroegher v. Calivada Colonization Co.*, 119 Fed. 641 (3d Cir. 1902).

⁷⁷ *Seymour v. Spring Forrest Cemetery Ass'n*, 144 N.Y. 333, 39 N.E. 365 (1895) (this case also held that no duty rests on an officer or director to purchase the claims for his corporation unless a specific fund has been ordered). In *Young v. Columbia Land & Inv. Co.*, 53 Ore. 438, 99 Pac. 936 (1909), it was held that controlling directors violated their fiduciary duties by taking claims originally offered to their corporation even though the latter had no plan for their acquisition.

⁷⁸ *Young v. Columbia Land & Inv. Co.*, *supra* note 77; *Fuller*, *supra* note 9.

⁷⁹ *In re Bridgford Co.*, 237 F.2d 182 (9th Cir. 1956); *Monroe v. Scofield*, 135 F.2d 725 (10th Cir. 1943); *In re Philadelphia & Western Ry.*, 64 F. Supp. 738 (E.D. Pa. 1946); *In re Los Angeles Lumber Prod. Co.*, 46 F. Supp. 77 (S.D. Cal. 1941); *In re McCrory Stores Corp.*, 12 F. Supp. 267 (S.D.N.Y. 1935); *Mothershead v. Douglas*, 215 Ark. 519, 221 S.W.2d 424 (1949); *Bonney v. Tilley*, 109 Cal. 346, 42 Pac. 439 (1895); *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928).

⁸⁰ *Punch v. Hipolite Co.*, 340 Mo. 53, 100 S.W.2d 878 (1936); *Glenwood Mfg. Co. v. Lyme*, 109 Wis. 355, 85 N.W. 432 (1901); *Fuller*, *supra* note 9, at 198.

⁸¹ An interesting problem in this area is presented by *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2d Cir. 1934), which states that for financial inability to be a defense in corporate opportunity situations the corporation has to be more than unable to acquire the opportunity, it must be insolvent. However, an officer or director cannot purchase at a discount and enforce for the full amount the claims against his corporation when it is insolvent.

⁸² *Du Pont v. Du Pont*, 256 Fed. 129 (3d Cir. 1916); *Sandy River R.R. v. Stubbs*, 77 Me. 594 (1885); *Thilco Timber Co. v. Sawyer*, 236 Mich. 401, 210 N.W. 204 (1926).

⁸³ *Manufacturers Trust Co. v. Becker*, 338 U.S. 304 (1949); *In re Calton Crescent, Inc.*, 173 F.2d 944 (2d Cir. 1949); *Monroe v. Scofield*, 135 F.2d 725 (10th Cir. 1943); *In re Philadelphia & Western Ry.*, 64 F. Supp. 738 (E.D. Pa. 1946); *In re McCrory Stores Corp.*,

III. BURDEN OF PROOF IN CORPORATE OPPORTUNITY SITUATIONS

As previously discussed, there is no concrete test for determining the existence of a corporate opportunity. Its existence is determined by the dictates of fairness in light of the circumstances in each case. The vagueness of the test makes the burden of proof unusually important. There is, however, no universal rule for placing the burden of proof in corporate opportunity situations.

If contracts or other direct dealings between an insider and his corporation are challenged as a deprivation of a corporate opportunity, the burden is on the insider not only to prove his own good faith, but also to show the inherent fairness of the transaction to the corporation,⁸⁴ *i.e.*, to show that it was not unfair for the insider to take the opportunity personally. This is, in essence, a showing of the nonexistence of a corporate opportunity. Furthermore, if the challenged transaction is between corporations having one or more common members on their board of directors, the burden of proof is also upon those who would maintain the transaction to show its entire fairness;⁸⁵ this situation is similar to direct dealing with his corporation by a director.

A different allocation of the burden of proof occurs if a dominating director or officer personally takes an opportunity after his corporation, through a dominated board of directors, has rejected it for "business judgment" reasons. Here, the party attacking the acquisition has the burden of proving that the director or officer dominates or controls the board of directors.⁸⁶ The dominance cannot be shown merely by the fact that the defendant owns enough stock to have the controlling interest in the corporation, that the defendant takes a vigorous interest in the affairs of the corporation, or that the defendant's views are strongly considered by the remaining officers or

12 F. Supp. 267 (S.D.N.Y. 1935); *Todd v. Temple Hosp. Ass'n*, 96 Cal. App. 42, 273 Pac. 595 (Dist. Ct. App. 1929); *Alexandrine Hotel Co. v. Whaling*, 313 Mich. 15, 20 N.W.2d 793 (1945); *Camden Safe Deposit & Trust Co. v. Citizens' Ice & Cold Storage Co.*, 69 N.J. Eq. 718, 61 Atl. 529 (Ch. 1905), *aff'd*, 71 N.J. Eq. 221, 65 Atl. 980 (Ch. 1907); *Inglehart v. Thousand Island Hotel Co.*, 32 Hun. 377 (N.Y. 1884); *William M. Moore Constr. Co. v. United States Fid. & Guar. Co.*, 293 N.Y. 119, 56 N.E.2d 74 (1944); *Seymour v. Spring Forrest Cemetery Ass'n*, 144 N.Y. 333, 39 N.E. 365 (1895).

⁸⁴ *Chenery Corp. v. SEC*, 128 F.2d 303 (D.C. Cir. 1942); *Lebold v. Inland Steel Co.*, 125 F.2d 369 (7th Cir. 1941); *Austrian v. Williams*, 103 F. Supp. 64 (S.D.N.Y. 1952), *rev'd on other grounds*, 198 F.2d 697 (2d Cir. 1952); *Maclary v. Pleasant Hills, Inc.*, 109 A.2d 830 (Del. Ch. 1954); *Knox Glass Bottle Co. v. Underwood*, 228 Miss. 699, 89 So. 2d 799 (1956).

⁸⁵ *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1920); *Mayflower Hotel Stock Protective Comm. v. Mayflower Hotel Corp.*, 193 F.2d 666 (D.C. Cir. 1951); *Pergament v. Frazier*, 93 F. Supp. 13 (E.D. Mich. 1950).

⁸⁶ *Austrian v. Williams*, 103 F. Supp. 64 (S.D.N.Y. 1952), *rev'd on other grounds*, 198 F.2d 697 (2d Cir. 1952); *Mayer v. Adams*, 167 A.2d 729 (Del. Ch. 1961); *Greene v. Allen*, 114 A.2d 916 (Del. Ch. 1955) (by implication); Note, 45 Calif. L. Rev. 183 (1957).

directors of the corporation.⁸⁷ However, once domination is shown by the plaintiff, then the dominating individual has the burden of showing a good faith rejection of the opportunity by the board of directors.⁸⁸

Still another allocation of the burden of proof occurs in situations other than (1) acquisition of an opportunity by a dominating individual after a rejection for "business judgment" reasons by the directors or (2) direct dealing situations. The burden here is upon the person attacking the acquisition, not upon the acquiring insider. The validity of this proposition is apparent from the holdings of many courts that the evidence presented in the cases before them was insufficient to establish that the particular acquisition was a corporate opportunity.⁸⁹ Moreover, the courts in *Colorado & Utah Coal Co. v. Harris*⁹⁰ and in *American Investment Co. v. Lichtenstein*⁹¹ expressly stated that in these situations the burden was upon the party attacking the transaction.⁹² One exception to this proposition has recently been created by the Texas Supreme Court in *International Bankers Life Ins. Co. v. Holloway*.⁹³ In placing the burden of proof on the insiders in a situation in which the insiders sold their previously acquired stock in their corporation in competition with a sale by their corporation of newly authorized shares, the court stated:

We agree with the defendants that only under special circumstances should stockholders who are also corporate fiduciaries have the burden of proving fairness to the corporation in the sales by them of their personally owned stock, or presumptively become liable for profits made in such sales. This is a case of such special circumstances. Here the interests

⁸⁷ *Austrian v. Williams*, *supra* note 86.

⁸⁸ An interesting result was reached in *Turner v. American Metal Co.*, 268 App. Div. 239, 50 N.Y.S.2d 800 (Sup. Ct. 1944), which involved a dominated board of directors. A great portion of a mining venture was taken by the directors and officers of a corporation after the directors had exercised their "business judgment" in rejecting it for their corporation because of its highly speculative nature. The court held that the directors and officers were entitled to the mining venture. It said that in the absence of proof that disinterested directors acted in bad faith the court may not presume they were not guided by sound business reasons. The case, therefore, demonstrates that when the opportunity is rejected by a nondominated board of directors, the burden of proving a bad faith rejection rests upon the party attacking the acquisition, rather than placing a burden of proving a good faith rejection on the party acquiring the opportunity. Furthermore, the party attacking the acquisition has the burden of proving a bad faith rejection even where members of the rejecting board of directors acquire the opportunity for themselves personally, for the court considers such directors as disinterested.

⁸⁹ *Kahn v. Schiff*, 105 F. Supp. 973 (S.D. Ohio 1952); *Greer v. Stannard*, 85 Mont. 78, 277 Pac. 622 (1929); *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S.E. 249 (1920).

⁹⁰ 97 Colo. 309, 49 P.2d 429 (1935).

⁹¹ 134 F. Supp. 857 (N.D. Mo. 1955).

⁹² See also *Outjes v. MacNider*, 232 Iowa 562, 5 N.W.2d 860 (1942) (burden is on the party seeking imposition of a constructive trust).

⁹³ — Tex. —, 368 S.W.2d 567 (1963).

of the corporation justly called for protection by the defendants of the opportunities for the sale of the stock of the corporation; they were under a duty to act in all respects to further the purposes of the corporation in offering its stock for sale and cannot seize the opportunities for themselves.⁹⁴

IV. LIABILITY OF SHAREHOLDER

An ordinary shareholder, for purposes of the corporate opportunity doctrine, is treated differently from a director or officer. Ownership and management are divorced in the modern corporation. Most stockholders do not occupy strategic corporate positions through which they can obtain profitable opportunities at the expense of their corporation. Furthermore, stockholders are not in a fiduciary relationship to their corporation such as to impose upon them a duty of loyalty toward their corporation. Therefore, in the absence of their domination or usurpation of the functions of the board of directors, thereby making themselves responsible for the action or inaction of the directors, there should be no shareholder liability under the corporate opportunity doctrine.⁹⁵

V. SIMILAR LIABILITY FOR DIRECTOR AND OFFICER

Liability of both officers and directors appears to be the same under the doctrine of corporate opportunity.⁹⁶ Many cases use the words "directors and officers" in discussions of the duty not to divert a corporate opportunity, thereby implying that the same duty and the same liability attaches to both.⁹⁷ In several cases, some defendants were officers and others were merely directors, but the courts did not find it necessary to distinguish between the two positions.⁹⁸

⁹⁴ *Id.* at 578.

⁹⁵ Several cases have held shareholders liable for diversion of corporate opportunities when the shareholders were found to have controlled or dominated the board of directors and hence have assumed the directors' liability. See *Perlman v. Feldman*, 219 F.2d 173 (2d Cir. 1955); *Lebold v. Inland Steel Co.*, 125 F.2d 369 (7th Cir. 1941); *Austrian v. Williams*, 103 F. Supp. 64 (S.D.N.Y. 1952), *rev'd on other grounds*, 198 F.2d 697 (2d Cir. 1952).

⁹⁶ *Carrington & McElroy*, *supra* note 6, at 965.

⁹⁷ *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); *Durfee v. Durfee & Canning, Inc.*, 323 Mass. 187, 80 N.E.2d 522 (1948); *Lincoln Stores, Inc. v. Grant*, 309 Mass. 417, 34 N.E.2d 704 (1941); *Hart v. Bell*, 222 Minn. 69, 23 N.W.2d 375 (1946); *Boxrud v. Ronning Machinery Co.*, 217 Minn. 518, 15 N.W.2d 112 (1944); *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913 (1944); *Rosenblum v. Judson Eng'r Corp.*, 99 N.H. 267, 109 A.2d 558 (1954); *Solimine v. Hollander*, 128 N.J. Eq. 228, 16 A.2d 203 (Ch. 1940); *Albert A. Volk Co. v. Fleschner Bros., Inc.*, 298 App. Div. 717, 60 N.Y.S.2d 244 (Sup. Ct. 1945); *Sutherland, Inc. v. Dahlen*, 357 Pa. 143, 53 A.2d 143 (1947).

⁹⁸ *Kaufman v. Wolfson*, 153 F. Supp. 253 (S.D.N.Y. 1957). The same result occurred in *Golden Rod Mining Co. v. Buckvich*, 108 Mont. 569, 92 P.2d 313 (1939), where one defendant was only a director. The court cited as authority for the imposition of liability on the director, *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S.E. 249 (1920), a corporate opportunity case in which an officer was the defendant. The *Golden Rod* case

VI. CONCLUSION

The early cases involving the corporate opportunity doctrine imposed a constructive trust upon property or profits acquired by an insider only under the relatively restricted circumstances in which a corporation had a property interest or "expectancy" in the opportunity. In these cases, the liability does not seem to have been based on a strict corporate opportunity doctrine. Rather, since the opportunities were so intimately related to the corporation's activities, their appropriation would seem to constitute a sufficiently direct interference with corporate enterprise to come within a general prohibition against injuring the corporation.

The refusal of the early courts to extend the doctrine, which left executives free to pursue their own interests in many situations of potentially great importance to their corporations, may have resulted from the severity of the constructive trust remedy. Imposition of a constructive trust sometimes permitted a corporation to recover, in addition to separate damages for any injury suffered, all profits earned by the defendant even if they were traceable solely to his initiative and skill and even though the risk of loss laid entirely on him. Whatever the motive for the early display of judicial caution, its strength apparently has diminished with the passage of time, and the recent cases have definitely expanded the corporate opportunity doctrine beyond the narrow pre-existing property interest idea.

The "fairness test" now expounded by the courts is, in essence, that the circumstances in each case should be weighed and a decision reached based on fairness and equity. Although the new test has done away with the property interest aspect of the old cases, it still has the objectionable aspects of vagueness and unpredictability of results. Furthermore, decisions have little precedent value for an attorney or judge since the new test is based on a balancing of facts. The fairness test is, however, more certain than the old rule, and there are particular facts which, if present, will be pivotal in the decision reached in a case. Once an attorney determines the existence of these facts, he can be reasonably sure of the court's decision regarding the corporate opportunity doctrine. Otherwise, all he can do is determine what appears to be the fairness of the situation, strenuously argue it to the court, and hope that his sense of fairness coincides with that of the court.

also holds that a director is subject to the same liability as an officer even if he is a "dummy director." *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2d Cir. 1934) (one of the defendants was an officer and director, but the other defendants were merely directors); *Blaustein v. Pan American Petroleum & Transp. Co.*, 293 N.Y. 281, 56 N.E.2d 705 (1944) (most of the defendants were directors, but three of them were officers).

The recent, more liberal application of the corporate opportunity doctrine can probably be explained as a judicial recognition of an affirmative duty on the executive's part to advance the interests of the corporation. This expansion of the legal duty of an executive to his corporation seems to reflect the increasing dominance of corporate enterprises in the American economy, the transition from the pragmatic morality of a period of rapid industrialization to the ethics of a society more concerned with consolidation and preservation of its gains, and the concomitant changes in corporate structure.⁹⁹ At a time when corporate ownership and management typically were fused in the same individuals, self interest encouraged a loyalty to the corporation, but in today's era of public ownership, stockholders are at the mercy of insiders whose ownership interest is small. Therefore, judicial sanctions forcing loyalty to a corporation have become necessary.

This necessity of protecting the stockholders has manifested itself not only by the more liberal corporate opportunity rule, but also, in many instances, by the placement of the burden of proof on the insider to show the lack of a corporate opportunity. The discharge of this burden is no easy task, for it requires the insider to persuade a court that certain factors so outweigh other factors that the acquisition of the opportunity by the insider would not be unfair to the corporation.

In their great concern for the welfare of public stockholders, the courts are over-protective to the extent that they treat directors of corporations the same as officers. This greatly curtails the independent investment opportunity of businessmen who are directors but not officers. Directors should be liable for a deprivation of corporate opportunities only under more limited circumstances than officers. Although officers are normally highly paid, full-time employees, directors generally receive small or nominal stipends and lend only a portion of their time to any one corporation. Therefore, it is unlikely that shareholders expect that they will manifest the single-minded devotion to corporate interests expected of officers. Such single-mindedness may be impossible in the case of a director who sits on the boards of many corporations. To make the director's obligation the same as the officer's exceeds the expectations of the parties to this consensual arrangement (*i.e.*, the directors and the shareholders), and such a result might unfairly trap individuals acting reasonably and in good faith. This argument is, of course, inapplicable if the direc-

⁹⁹ Berle & Means, *The Modern Corporation and Private Property* 18-46 (1932). See generally Holbrook, *The Age of Moguls* (1933).

tor's customary role has been enlarged by special agreement, express or implied, as may often be the case in a closely held corporation. But under normal corporate operations, it is appropriate for the courts in determining the fairness of the transaction to consider that a director rather than an officer was involved, at least as a factor weighing in his favor.

Although the corporate opportunity doctrine is a judicial sanction to insure the exercise of an executive's affirmative obligation of loyalty to his corporation, it provides for only a negative enforcement of that obligation. However, the courts' refusal to allow suits to compel affirmative executive action or to recover damages for inaction appears to be based on sound policy. First, entertaining such actions might encourage a plethora of strike suits, although requiring security for costs and demand upon shareholders as prerequisites to bringing such actions would significantly mitigate this danger. Second, such actions would require frequent judicial review of business judgment, with the likely result of subjecting corporate management to the danger of unpredictable liability. Further, the calculation of damages—presumably the profits the corporation would have obtained had the opportunity been exploited by it—would seem virtually impossible.

The courts have avoided these potential dangers in enforcing the executive's affirmative obligation by acting only to remedy his misappropriations of corporate opportunities by transferring to the corporation the opportunity which belongs to it, plus whatever profit has been realized. This remedy, based as it is upon a determination of unfairness, appears to make the present corporate opportunity doctrine a practicable and equitable judicial sanction for enforcing corporate loyalty by insiders in today's era of public corporate ownership.