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EXPANDING THE CORPORATE OPPORTUNITY DOCTRINE

Corporate opportunity doctrine is a legal principle rooted in case law which mandates that directors, officers and controlling shareholders of an organization, must present potential business opportunities to the organization before pursuing them personally. It stems from directors' fiduciary duties that require them to put the interest of the organization above their own. While traditionally applied to prevent executives from usurping corporate opportunities, the doctrine's logic has the potential to extend further. The purpose of this article is to argue that the doctrine should also expand to include the **scenario where an executive officer receives a viable business opportunity on behalf of a corporation and contemplates rejecting it. Even if the executive intends to decline the offer, they should present it to the Board for consideration rather than dismiss it outright.** The proposition is based on the reasoning that although the Board approves the corporate strategy, it remains somewhat detached from market realities. Opportunities that appear inconsistent with the existing strategy may still provide valuable insight into shifting market conditions. Considering such opportunities could help the Board evaluate whether the current strategy remains relevant or requires adjustment. By extending the doctrine in this way it would not only continue to address conflicts of interest but also bridge an information gap between management and the Board - enabling more informed strategic oversight. The article also recognizes the practical challenge of defining which types of opportunities should require Board presentation and which may be legitimately declined by executives without Board deliberations.

Before proceeding with the thesis statement, let's unpack the corporate opportunity doctrine. Corporate opportunity doctrine, i.e. duty not to usurp corporate opportunities is a manifestation of fiduciary duties. The latter, having their origin in trust law, place uncompromising standards of honesty, loyalty and good faith on fiduciaries and expect them not only to affirmatively protect the interests of the corporation, but also to refrain from depriving the corporation "of profit or advantage which his skill and ability might properly bring to it".¹ The doctrine consists of several key components: it prohibits the usurpation of opportunities that belonged to the corporation by directors and officers, provides a test on how to determine whether an opportunity belonged to a corporation, sets the conditions when a corporate opportunity can

¹ Guth v. Loft, Inc., 23 Del. Ch. 255 (1939), 270

definitely be pursued by directors or officers (safe harbor) and provides the consequences of violating the duty that prohibits the usurpation of corporate opportunities.

Central to the doctrine is the line between when an opportunity belongs to a corporation and when it does not and therefore the respective fiduciary is free to pursue it for personal interest. Basing itself on *Guth v. Loft, Inc.* in *Broz v. Cellular Info. Systems, Inc.*, the Supreme Court of Delaware articulates a test on when an opportunity is deemed to belong to the corporation. Namely, an opportunity legitimately belongs to the corporation if “(1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.” In the same case, the Court further delineates the circumstances under which an opportunity is not deemed to belong to the corporation: “A director or officer may take a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.”² Numerous case law exists that elaborates on each of the components of the test.

In *Field v. Allyn*, the Delaware Court of Chancery clarified that the corporate opportunity doctrine does not place an absolute prohibition on pursuing transactions in which the corporation might have an interest. As the Court states – “It is only a misuse of the fiduciary position that is prohibited”. A director or an officer “is also free to take a business opportunity for himself once his corporation has properly rejected the opportunity or if it is established that it is not in a position to take it”. In *Broz v. Cellular*, the Supreme Court of Delaware clarified that although presenting a corporate opportunity to the Board is not a mandatory requirement for determining whether a particular opportunity was within the interest, expectancy or ability of a corporation, doing so creates a safe harbor.³ At the same time, when attempting to rely on such a safe harbor, one must ensure that complete and accurate information on the opportunity was presented to the Board and that the decision on rejection was made in compliance with conflicts of interest rules (e.g. the minimum required votes of disinterested directors were casted).⁴ If either of these conditions is not met, there is a risk that the opportunity will not be considered duly rejected and such decision will not be strong in proving that the corporation held no interest or expectancy in the opportunity.

Given the elevated status of fiduciary duties, Delaware case law imposes severe consequences for breaches involving the usurpation of corporate opportunities. *Guth v. Loft* summarizes the rule on consequences and the rationale of such harsh liability as follows: “If an officer or director of a corporation, in violation of his duty as such, acquires gain or advantage for

² *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 154–55 (Del. 1996), 155

³ *Id.*, 157

⁴ “LAW OF CORPORATE OPPORTUNITIES: A COMPARATIVE ANALYSIS” Julien Koch Member of the Paris Bar Vivien & Associés

himself, the law charges the interest so acquired with a trust for the benefit of the corporation, at its election, while it denies to the betrayer all benefit and profit. The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.”.

Interestingly, the Delaware General Corporation Law allows that the certificate of incorporation of the corporation ex ante provides a renouncement of opportunities. This means that if a certificate of incorporation renounces certain business opportunities, such opportunities can be freely pursued by officers, directors or shareholders without the need to first present the opportunity to the corporation.

As one may infer from above, corporate opportunity doctrine is about addressing a certain type of duty of loyalty breaches. With some tweaks the doctrine can also serve as a useful tool for bridging an information gap between the Board and the Management. The suggested additional feature to the doctrine reads as follows: if an executive officer receives a major and realistic business offer on behalf of the corporation but intends to decline it, including on the ground that it contradicts existing Board approved strategy, instead of rejecting it outright, they have a duty to present it to the Board. To better demonstrate the issue we are attempting to resolve with the suggested rule let's consider a single example. The example is simplified and somewhat overstated for better illustration. ABC handbag store is well established in the market, the strategy of ABC handbag states that the store should have its niche product and concentrate its resources on few product types rather than have a wide variety of them. In this light, the strategy allows the company to produce handbags, belts, hats and other accessories but strictly prohibits the production of a clothing line as it will distort the brand image. Now suppose a talented but not so wealthy textile engineer approaches the CEO of the company and demonstrates that he has invented a new ethereal material that can change the history of cloth production. A few days ago the CEO had also received a call from the main leather supplier informing that due to the rising prices in the leather market they plan to significantly increase prices, which means decreasing profit margins for the company. The Board, being detached from daily operations, is naturally not aware or at least not immediately aware of these circumstances. It has approved the strategy requiring focus on niche products with strict prohibition on launch of a clothing line and expects the executive to strictly comply with it. Imagine that the same Board also frowns upon any suggestions on deviating from the Strategy, especially mid-year. The CEO is hesitant to bring the opportunity to the Board, due to concerns about possible negative reactions, and eventually declines the offer. The Board never becomes aware of such a state of affairs and continues to oversee the existing strategy without having a hint of the pressing need of its adaptation. A few months later the Board receives quarterly financial reports where they see the decreased profit margins and an era of decline begins for the company. Had the Board been presented with the opportunity on pursuing the clothing line business with the newly invented material coupled with the information on rising leather prices, chances are the

Board would consider adapting the strategy. Thus, a simple rule could change dynamics between Board and Management communication, which in turn would prevent the company's deterioration. Of course, real life situations are far more complex and nuanced than the example cited.

At this point, one would rightly remark "Easier said than done". The challenge to incorporating such a rule in the corporate opportunity doctrine is drawing the scope on which of the opportunities Management can reject independently and which of them they may not reject without consulting with the Board. Another related challenge is ensuring that Management does not have the incentive to present the opportunities to the Board "just in case and to be on the safe side" in that way overburdening the Board with myriad of irrelevant opportunities. To mitigate the issue, we propose a two prong test for capturing the opportunities that can not be rejected by the Management without presenting to the Board:

- **Materiality** - Given the Board's role and mandate, not all opportunities should be presented to the Board but rather those that can have a strategic impact. A not ideal but simple metric for determining whether an opportunity can have a strategic impact, is the potential level of profit it may generate. Thus, to satisfy the first prong of the test the opportunity should be capable of rendering profit to the company equal to at least a certain threshold of its capital. The Board can decide on the exact threshold.
- **Feasibility** - From an efficiency perspective, to allocate time on deliberating about a business opportunity, the chance to achieve the level of profit specified above shall be realistic and not remote.

Having made a suggestion on expanding the corporate opportunity doctrine, the fact that the extension of the doctrine is not embedded in the current legal framework as a mandatory rule, does not mean that the corporations may not adopt this practice voluntarily. It would be prudent for the Board to consider establishing the scope of business opportunities that the executives may not reject on their own by also specifying criteria of materiality and feasibility. This understanding should be legally formulated in a relevant internal document or the articles of association and duly communicated to the Executive Management.