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***COMPLEXITY IN CORPORATE GOVERNANCE:
THE CASE OF CORPORATE OPPORTUNITIES***

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COMPLEXITY IN CORPORATE GOVERNANCE: THE CASE OF CORPORATE OPPORTUNITIES[†]

By

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A central challenge in designing corporate governance systems revolves around the question of how to navigate the fundamental tradeoff between nuance and practicality. While sophisticated, highly contingent governance schemes are often the most targeted means for structuring incentives within business organizations, implementing such mechanisms in practice can prove not only costly, but also potentially quite hazardous. Indeed, complexity – by its very nature – oftentimes *encourages* nearly as much strategic behavior as it purports to deter; and in such situations, it is quite reasonable to wonder whether the regulatory game is ultimately worth the candle.

The tradeoff between nuance and practicality is perhaps nowhere more stark than it is in the context of the fiduciary obligation that managers have not to compete with their own firm, and in particular the duty that fiduciaries have not to appropriate “corporate opportunities” – business prospects that the firm is itself capable of (and interested in) pursuing. It is in this context that the incentives of the firm and the fiduciary not only run askew, but rather are likely to be in profound opposition to one another. As such, disputes over what prospects “belong” to the firm versus the fiduciary are both incredibly common and notably vexatious.

The legal regulation of corporate opportunities also exposes an interesting heterogeneity from an international perspective. Even within developed economies, the complexity of regulations concerning corporate opportunities varies dramatically by country, and not even along common law / civil law axes. In the United Kingdom, for example, fiduciaries are generally subject to strict categorical proscriptions, and those who divert a project for their own interests will generally be held liable even if the conflict between personal interest and duty is nothing

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more than a mere possibility.¹ In the United States, in contrast, the applicability of the legal proscription is significantly more contingent and nuanced, frequently allowing a corporate fiduciary to appropriate new business prospects under certain predicate conditions. Other common law countries, such as Canada and New Zealand, tend to fall somewhere in between, allowing a small set of limited exemptions to the otherwise categorical proscription.²

In order to understand the potential costs of legal complexity (at least in this important context), this article explores how the “Corporate Opportunity Doctrine” (or COD) operates in most American jurisdictions. Against this doctrinal backdrop, I shall then return to the special considerations that transitional economies face in navigating this nuance-practicality tradeoff. Here I argue that a number of characteristics distinct to developing economies render complex legal regulations (such as the COD) particularly imprudent.

Before launching into my principal argument, however, I should offer at least one disclaimer. My focus in this paper (at least initially) on American corporate governance schemes is not meant to convey a sense of doctrinal parochialism, exceptionalism or triumphalism. To the contrary, I believe the experience in the United States concerning the COD presents a cautionary tale for others who might aspire to mimic its complexity. In spite of the best intentions of scholars, legislators and judges, the precise contours of the doctrine in the United States remain frustratingly elusive, fraught with contingencies indecipherable distinctions that have rendered the doctrine immensely unpredictable, and periodically subject to scrupulous exploitation by strategic parties. Of all the various governance devices for ensuring loyalty of fiduciaries,³ the COD is in many ways both the most complex and the most dysfunctional. That it claims both honors simultaneously, I believe, is far from coincidental.

Who Is the Principal Target of the COD?

Although many of the constituent sub-doctrines comprising the fiduciary duty of loyalty overlap considerably, what immediately distinguishes the COD in practice is its relatively targeted scope. Indeed, the COD pulls within its ambit duties that extend *predominantly* to corporate directors and officers, but *generally not* to other agents, employees, or stakeholders in the firm.⁴ This observation is significant, because it suggests that the underlying motivation behind the COD

¹ See, e.g., John Lowry & Rod Edmunds, *The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolutism*, JOURNAL OF BUSINESS LAW, 2000, Mar, 122-142

² See, e.g., *Canadian Aero Services Ltd v. O'Malley* (1973) 40 D.L.R. (3d) 371; *S.S.C. & B. Lintas New Zealand Ltd v. Murphy* (1981) 1 N.Z.C.L.C. 95-046; *C.B.A. Finance Holdings Ltd v. Hawkins* (unreported, High Court, Auckland, Barker J., April 2, 1984).

³ Others include the duty not to compete with the corporation, the duty not to appropriate trade secrets, and the duty not to act as an adverse party in transactions with the corporation. These doctrines are not addressed here. For more on their relationship with the COD, see Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 Yale L. J. 299 (1998).

⁴ See LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS (3d ed. 1996), at 546-47. It should be noted that on occasion, the COD has been applied to other relationships of trust and confidence within the firm. See, e.g., *A. Teixeira & Co. v. Teixeira*, 699 A.2d 1383, 1387 (R.I. 1997) (holding that the COD applies to a shareholder not affiliated with management if that shareholder actively participates in management decisions).

has relatively little to do with day-to-day incentive problems on the proverbial factory floor. On the contrary, officers and directors play little or no direct role in routine production operations. Rather, what these corporate fiduciaries appear jointly to share from an agency-cost perspective is a macro-organizational role as “gatekeepers.” Unlike rank-and-file employees or mid-level management, directors and officers play a predominant role in evaluating the relative merits of prospective new business projects, recommending which the firm should pursue and which it should eschew.⁵ It therefore seems plausible (if not likely) that one of the primary purposes of the COD is to address incentive problems that are unique to this gatekeeping function.

Who Is Eligible to Bring a COD Action?

Formally, it is the corporation that benefits from a fiduciary’s duty of loyalty. Thus, in most instances, the corporation must itself assert its rights against a current or (more typically) former officer or director who has usurped an opportunity. Nevertheless, shareholders may also attempt to make use of the derivative action to compel an unwilling board to assert a corporate opportunity claim. In such instances, the familiar constraints on derivative actions (such as demand futility requirements, and, where applicable, minimum holding requirements and the posting of security for expenses) continue to apply.⁶ Typically, such claims are uniquely derivative in nature, and are therefore difficult to categorize as direct.⁷

⁵ This information-processing role is widely recognized in the corporations literature. The following excerpt from Robert Clark is typical:

[A] very large portion of any manager’s job consists of gathering, evaluating, relating, and dispensing pieces of *information*. He or she is an information processor par excellence. The term *information* is used here in a broad sense: it includes not only bits of factual data, judgments, opinions, and predictions, but also requests, advice, and commands within a firm, and bids and offers among those who potentially might make a deal of some sort. Included within the manager’s information processing tasks is the activity of making business *decisions*

ROBERT CHARLES CLARK, CORPORATE LAW 802-03 (1986). Though one’s initial inclination is to ascribe these gatekeeping duties primarily to officers and inside directors, there is mounting evidence that outside directors are increasingly playing a similar role. *See, e.g.*, Hobson Brown, Jr., *What Do Institutional Investors Really Want?*, CORP. BOARD, May 1996, at 5; Robert H. Campbell, *Directors: ‘The Brokers of Balance,’* DIRECTORS & BOARDS, June 1996, at 45; Robert F. Felton et al., *Building a Stronger Board*, MCKINSEY Q., Mar. 22, 1995, at 162; Keith J. Loudon, *A Position Description for the Board*, DIRECTORS & BOARDS, Mar. 22, 1993, at 23.

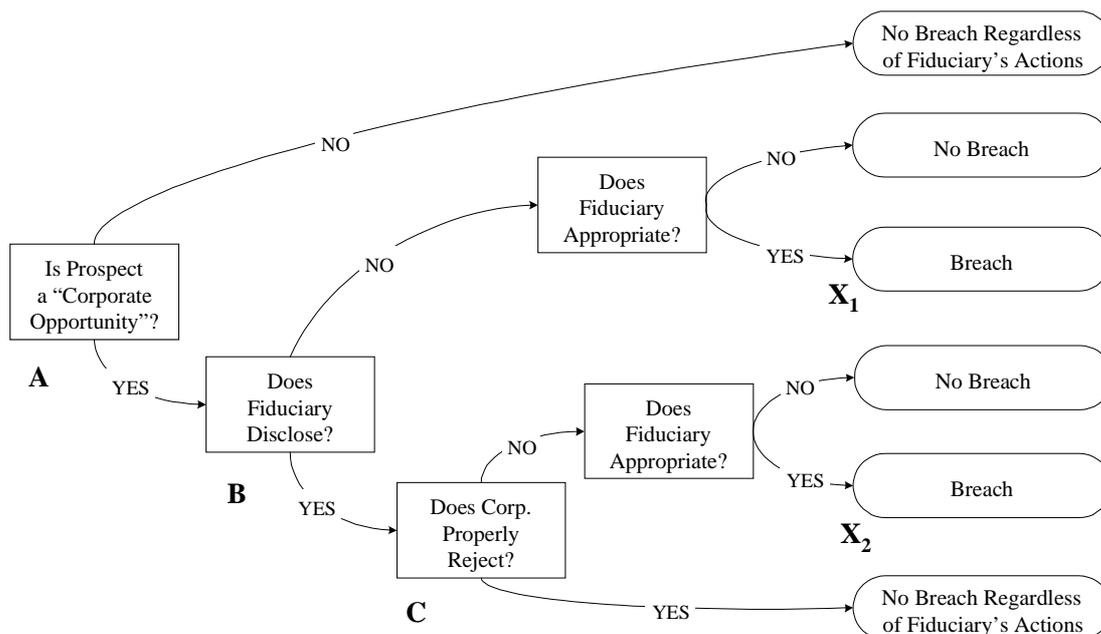
⁶ *See, e.g.*, CAL. CORP. CODE § 800 (1999).

⁷ *See, e.g.*, *In re: Digex Inc. Shareholders Litigation*, 2000 WL 1847679, at *10 (noting that “[a] claim that a director or officer improperly usurped a corporate opportunity belonging to the corporation is a derivative claim”).

What is the Basic Structure of a COD Dispute?

Most modern corporate opportunity disputes follow a facially simple analytical algorithm, represented below by Figure 1:

FIGURE 1. A SIMPLE ROAD MAP OF THE CORPORATE OPPORTUNITIES DOCTRINE



The figure presupposes that a new business prospect has recently been presented to a corporate fiduciary, and it traces the parties' subsequent actions along with the legal consequences thereof. The first relevant legal inquiry occurs at node A, where a court must determine whether the project in question constitutes a "corporate opportunity." If not, the legal inquiry ends: Absent express language to the contrary in the corporate charter or employment contract,⁸ the fiduciary may pursue the prospect at will. On the other hand, if a corporate opportunity is found to exist, the inquiry proceeds to node B, where the court attempts to ascertain whether the fiduciary has fully disclosed the opportunity (along with her interest in it) to the corporation. If she has not, then any authorization, approval, or ratification by the firm is voidable, and an appropriation of the project by the agent constitutes a breach of fiduciary duty. Conversely, if the fiduciary discloses fully, the inquiry proceeds to node C, where the corporation may "reject" the tendered opportunity, thereby offering it back to the fiduciary. If rejection occurs, then the fiduciary may freely appropriate the project subject to the conditions (if any) attached to the rejection. On the other hand, if the corporation fails to reject (or it rejects "improperly"⁹), the fiduciary may not appropriate the project without incurring liability. Finally, at those terminal nodes X_1 and X_2 , which signify a breach of fiduciary duty, a court imposes the appropriate remedy.

⁸ Whether an action of the corporation can expand and/or limit the reach of the COD is taken up at greater length below.

⁹ See *infra* text accompanying notes 39-42 (defining proper rejection).

Although the structure of the above algorithm is easy to recite, its practical application has proven much more elusive than its rhetorical structure. While a comprehensive review of these difficulties is beyond the scope of this article, some of the important details found at each node are sketched out in the sections that follow.

What Sorts of Business Prospects Constitute Corporate Opportunities?

Typically, the first task for a court in a corporate opportunities case is to characterize whether the disputed project is, in fact, a “corporate opportunity.” This single determination has proven to be the most confusing in practice, and jurisdictions (and even courts within the same jurisdiction) have oscillated among numerous characterization tests, summarized below. Perhaps reflecting the disarray that permeates current doctrine, the tests described below tend to overlap in a number of contexts.¹⁰

1. The “Interest-or-Expectancy” Test

The longest-standing characterization test for determining whether new business prospects are corporate opportunities turns on whether the corporation has an active commercial *interest* or *expectancy* in such opportunities. The “interest” component of this approach usually refers to projects over which the corporation has an existing contractual right.¹¹ The “expectancy” component includes projects that, while not already secured through an express contract, are likely, given current rights, to mature into contractual rights at some future date.¹² Of particular relevance here are so-called “relational” contracts between the corporation and repeat trading partners, in which periodic extensions are not expressly provided for but can be reasonably assumed.¹³

Notably, the interest-or-expectancy test ultimately defines a corporate opportunity largely by reference to *current* (rather than prospective) activities of the corporation. As such, the test provides a relatively predictable boundary. Indeed, the narrow reach of the test effectively limits it to those projects about which the firm (by virtue of its existing contractual rights) already has actual or reasonable knowledge. Despite its administrative convenience, however, the test has

¹⁰ In fact, legal scholars have noted that courts will often pronounce one test and then proceed to apply another. See, e.g., Pat K. Chew, *Competing Interests in the Corporate Opportunity Doctrine*, 67 N.C. L. REV. 435, 465-66 (1989), at 465-66.

¹¹ See, e.g., *Lagarde v. Anniston Lime & Stone Co.*, 28 So. 199 (Ala. 1900) (holding that corporate fiduciaries who purchased a two-thirds interest in a limestone quarry appropriated a corporate opportunity as to a portion of their purchase, since the quarry had already secured a contractual agreement from the seller for that portion). Some courts applying the interest-or-expectancy test have placed the additional requirement that the opportunity must be “necessary,” “essential,” or at least extremely important to the corporation before a court will deem there to be a prospective interest. See CLARK, *supra* note 4, at 226.

¹² See CLARK, *supra* note 4, at 225; JAMES D. COX ET AL., *CORPORATIONS* 237 (1997) (describing the doctrine as unpredictable and noting that “a good deal of uncertainty exists as to what constitutes the usurpation of a corporate opportunity”).

¹³ Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under the Classical, Neoclassical, and Relational Contract Law*, 72 N.W. U. L. REV. 854 (1978).

been criticized as under-inclusive because it reaches *only* those projects over which the corporation's proprietary claim is relatively mature.¹⁴ Because many business projects do not reap rewards (in, say, the form of significant market share) until long after an initial investment, the argument goes, a characterization rule that protects only mature rights runs the risk of decreasing the *ex ante* incentives of the shareholders to invest in long-term projects.¹⁵ As such, while virtually all jurisdictions still employ the interest and expectancy tests, they have been receptive to various expansions of the doctrine as well.

2. The "Line-of-Business" Test

Under the most prominent such extension, a new business prospect constitutes a corporate opportunity if it is deemed to fall within the firm's "line of business." According to most judicial accounts, this test pulls within its ambit any project that the corporation—given its assets, knowledge, expertise, and talents—could reasonably be expected to adapt itself to pursue *now or in the reasonable future*. The most often-quoted articulation of the test appears in the Delaware case of *Guth v. Loft, Inc.*, which characterized the inquiry as follows:

Where a corporation is engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business.¹⁶

The line-of-business test (or a close variant) is now embraced by a significant number of jurisdictions,¹⁷ and perhaps for good reason: Unlike its doctrinal forebear (the interest-or-expectancy test), the line-of-business test reaches beyond *current* contractual interests of the firm, and sweeps in prospective areas of growth as well, giving the doctrine a significantly more dynamic (and realistic) flavor.

¹⁴ See CLARK, *supra* note 4, at 226-27 (noting that the interest-or-expectancy test is easier for executives to meet than other tests, and that its notion of duty is a negative conception, rather than an affirmative obligation); COX ET AL., *supra* note 11, at 237 (labeling the test as "lax" toward defendants); Chew, *supra* note 9, at 460. The narrow reach of the interest-or-expectancy test is illustrated in *Lagarde*, in which the Alabama Supreme Court held that "[g]ood faith to the corporation does not require of its officers that they steer from their own to the corporation's benefit, enterprises, or investments, which, though capable of profit to the corporation, have in no way become the subjects of their trust or duty." *Lagarde*, 28 So. at 202.

¹⁵ See, e.g., COX ET AL., *supra* note 11, at 237.

¹⁶ 5 A.2d 503, 514 (Del. 1939).

¹⁷ Chew, for example, finds that as of 1989, *Guth v. Loft, Inc.* was the single most cited case among reported COD decisions. See Chew, *supra* note 9. Moreover, a number of prominent states (other than Delaware) currently follow the line-of-business test articulated in *Guth* (either exactly or with a close variant), including California, Connecticut, Illinois, and Ohio. See, e.g., Kelegian v. Mgrdichian, 39 Cal. Rptr. 2d 390, 393-94 (Ct. App. 1995); Katz Corp. v. T.H. Canty & Co., 362 A.2d 975, 979 (Conn. 1975); Levy v. Markal Sales Corp., 643 N.E.2d 1206, 1214-15 (Ill. App. Ct. 1994); Hubbard v. Pape, 203 N.E.2d 365, 368 (Ohio Ct. App. 1964).

Operationally, most opinions purporting to apply the line-of-business test frequently employ a conceptual metaphor of “distance” to characterize the strength of the corporation’s proprietary claim over the disputed project. In particular, the determination of whether an opportunity is within a firm’s *line of business* turns on the court’s perception of the relative distance between the project’s requirements on the one hand, and the corporation’s expertise on the other. Courts that use this approach view their task as evaluating the relative burdens and difficulties that the firm might have in bridging this specialization gap through adaptation of its managerial strategies, production techniques, capital structure, and the like.¹⁸ Once this distance reaches a critical threshold, the burdens of adaptation are apparently deemed to be so large that the project no longer is in the firm’s line of business.

Despite the popularity of this characterization test, its greater generality may well come at the cost of increasing judicial uncertainty. Indeed, opinions applying the test appear to vary substantially in prescribing the precise universe of circumstances in which a project falls within the firm’s cognizable line of business.¹⁹ For some courts, this domain is surprisingly small, encompassing only those opportunities that either are clearly linked to a corporation’s existing operations or would put the fiduciary in direct competition with the firm’s current endeavors.²⁰

¹⁸ See, e.g., *Balin v. Amerimar Realty*, No. 12896, 1996 Del. Ch. LEXIS 146, at *1 (Nov. 15, 1996); *Miller v. Miller*, 222 N.W.2d 71 (Minn. 1974); *Klinicki v. Lundgren*, 695 P.2d 906 (Or. 1985); *Imperial Group, Inc. v. Scholnick*, 709 S.W.2d 358 (Tex. Ct. App.—Tyler 1986, writ ref’d n.r.e.). In particular, the fact that a disputed project appears to fall within the “long-range plans” of the corporation may constitute strong evidence that the project is within the firm’s line of business.

While the distance metaphor is most applicable to the line-of-business test, a similar conceptual intuition is present in others. See, e.g., Klaus J. Hopt, *Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors’ Conflicts of Interest*, in *CORPORATE GOVERNANCE AND DIRECTORS’ LIABILITIES* 299 (Klaus J. Hopt & Gunther Teubner eds., 1985) (describing the lack of clarity in the tests but noting that “[t]hey all try to describe points on a scale between an asset or business which undoubtedly belongs to the corporation . . . and an opportunity or chance which has nothing to do with the corporation and its business” (citation omitted)).

¹⁹ See *id.* at 228 (noting that a court could interpret the line-of-business test very narrowly or very broadly).

²⁰ See *Castleman ex rel. Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 443 (Del. 1996) (noting that “[g]enerally, the corporate opportunity doctrine is applied in circumstances where the director and the corporation compete against each other” and that “those transactions which [are] not economically rational alternatives need not be considered by a court evaluating a corporate opportunity scenario”); *Johnston v. Greene*, 121 A.2d 919 (Del. 1956) (allowing a corporate director to retain patents related to business that was offered to the corporation); *Guth*, 5 A.2d at 513 (stating that “[t]he real issue is whether the opportunity . . . was so closely associated with the existing business activities of [the plaintiff], and so essential thereto, as to bring the transaction within that class of cases [in which appropriation] would throw the corporate officer . . . into competition with his company”); *Turner v. American Metal Co.*, 50 N.Y.S.2d 800 (App. Div. 1944) (holding that a molybdenum mining venture was not sufficiently related to the *ongoing* business of a metal company dealing in copper, lead, zinc, gold, and silver, and the smelting, refining, and marketing of such metals, to constitute a corporate opportunity); *Solimine v.*

Other courts have prescribed a larger domain, measuring relative similarity in terms of potential profitability and whether the pursuit of the opportunity presents a “practical advantage” to the corporation²¹ or fits within its prospective plans for expansion.²² Still others have expanded this domain further still, utilizing a test that ensnares any project that the corporation has the technological and financial *ability* to pursue and develop, apparently without regard to what is economically practical for the firm to undertake.²³ In addition to the case law, the American Law Institute’s *Principles of Corporate Governance* utilizes what is essentially an intermediate line-of-business test (albeit one that distinguishes between officers and directors). Section 5.05 proscribes the taking of projects in which a director or senior executive knows or has reason to know that the corporation is interested, *and* all projects that a senior executive has reason to know are closely related to the corporation’s current or anticipated future business.²⁴

3. The “Fairness” Test

Over the last twenty-five years, a small number of jurisdictions have attempted even greater refinements to the doctrine, developing a test of “fairness” to characterize the existence of a corporate opportunity. Under such an approach, an opportunity is deemed to be a corporate one if a fiduciary’s appropriation would not satisfy “ethical standards of what is fair and equitable [to the corporation in] particular sets of facts.”²⁵ Much like the line-of-business test, the fairness test may proscribe the appropriation of either existing or prospective activities of the firm. Accordingly, courts employing this approach frequently encounter line-drawing problems when deciding which projects qualify as corporate opportunities.

An even more vexing concern for courts employing a fairness test, however, is the challenge of articulating exactly what “fairness to the corporation” means. Jurisdictions adopting this test have had little success in articulating—beyond recapitulations of the above rhetoric—the substantive contours of a fairness approach. Elaborate attempts to supply them appear to do little

Hollander, 16 A.2d 203 (N.J. Ch. 1940) (dismissing a derivative action against directors acting in their individual capacities).

²¹ See, e.g., *David J. Greene & Co. v. Dunhill Int’l, Inc.*, 249 A.2d 427 (Del. Ch. 1968); *Paulman v. Kritzer*, 219 N.E.2d 541 (Ill. App. Ct. 1966) (applying Delaware law), *aff’d* 230 N.E.2d 262 (Ill. 1967); *Schildberg Rock Prods. v. Brooks*, 140 N.W.2d 132 (Iowa 1966).

²² See, e.g., *Central Ry. Signal Co. v. Longden*, 194 F.2d 310 (7th Cir. 1952); *Rosenblum v. Judson Eng’g Corp.*, 109 A.2d 558 (N.H. 1954); *Turner*, 50 N.Y.S.2d at 800.

²³ See, e.g., *Irving Trust Co. v. Deutsch*, 73 F.2d 121, 124 (2d Cir. 1934) (prohibiting fiduciaries from pursuing any opportunities); *Paulman*, 219 N.E.2d at 545 (same).

²⁴ See also AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE [hereinafter ALI PCG] § 5.05 (1992). In addition to this “project-based” characterization, the ALI Principles also take into account (for outside directors) the *source* of the information when it comes to directors. The ALI approach has now been embraced by a few courts, and it is cited favorably by others. See, e.g., *Northeast Harbor Golf Club v. Harris*, 661 A.2d 1146, 1149 (Me. 1995); *Demoulas v. Demoulas Super Mkts.*, 677 N.E.2d 159, 181 n.36 (Mass. 1997); *Derouen v. Murray*, 604 So. 2d 1086 (Miss. 1992); *Klinicki v. Lundgren*, 695 P.2d 906, 917-20 (Or. 1985).

²⁵ *Durfee v. Durfee & Canning, Inc.*, 80 N.E.2d 522, 529 (Mass. 1948) (citing HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS 204-05 (rev. ed. 1946)).

more than advocate judicial casuistry and flexibility,²⁶ often offering digests of guiding principles that essentially replicate other extant characterization tests.²⁷ Corporations scholars likewise have had difficulties formulating a theory of fairness as a foundational premise for fiduciary duties, leading some scholars to argue (in a more general context) that the very notion of “fairness” has vastly more procedural than substantive significance.²⁸ These shortcomings have, in part, led commentators and courts to proclaim that the fairness test as applied to the COD merely muddies the waters,²⁹ adds new layers of confusion to already murky doctrine,³⁰ and provides no predictable guidelines.³¹ Perhaps consequently, the fairness test has held only modest sway among courts.

4. *Alternative and Hybrids*

In addition to the pure approaches described above, many courts over the years have varied, combined, hybridized, and supplemented the traditional tests in an attempt to refine the characterization rules. The amalgam of the line-of-business and the interest-or-expectancy tests seems particularly strong in this regard,³² but other combinations are possible. Minnesota courts,

²⁶ See, e.g., Annotation, *Fairness to Corporation Where “Corporate Opportunity” Is Allegedly Usurped by Officer or Director*, 17 A.L.R.4th 479 § 2 (1996) (collecting authorities and concluding that “[s]ince the question whether a director or officer has appropriated for himself something that in fairness should belong to his corporation is a factual one to be decided by reasonable inference from objective facts, . . . [t]he result in any particular case has hinged on the surrounding circumstances and particular actions that allegedly constituted a breach of the corporate opportunity doctrine”).

²⁷ Ballantine lists a number of factors implicated by the tests, including whether the opportunity was of special value to the corporation, whether the corporation was actively negotiating for the opportunity, whether the corporation was in a financial position to pursue the opportunity, and whether the fiduciaries would be put in an “adverse and hostile position” to the corporation; whether the fiduciaries received the opportunity because of their corporate positions, whether the fiduciaries were delegated to pursue the opportunity on behalf of the corporation, whether the fiduciaries used corporate resources in identifying or developing the opportunity, and whether the fiduciaries intended to resell the opportunity to the corporation. See BALLANTINE, *supra* note 24, at 206.

²⁸ See Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 426-29 (1993).

²⁹ See CLARK, *supra* note 4, at 229.

³⁰ See *Northeast Harbor Golf Club, Inc. v. Harris*, 661 A.2d 1146, 1149-50 (Me. 1995); Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 998, 998-99 n.2 (1981).

³¹ See Chew, *supra* note 9, at 462.

³² In a recent Delaware Supreme Court opinion, for example, the corporation’s “line of business” and its “interest or expectancy” are both named as applicable tests that should be factored into an evaluation of the facts and circumstances of each case. *Broz v. Cellular Info. Sys.*, 673 A.2d 148, 155 (Del. 1996). Interestingly, however, the Delaware court’s conception of the interest-or-expectancy test appears to be somewhat broader than its historical predecessors in that it need not involve *current* contractual rights. See *id.* at 156 (stating that “[f]or the corporation to have an actual or expectant interest in any specific property, there must be some tie between that

for instance, conduct a two-step analysis that is effectively a combination of the line-of-business test and the fairness inquiry.³³ Hybrid approaches of this latter sort generally have met with considerable disapprobation, and, in the words of one court, “pile[] the uncertainty and vagueness of the fairness test on top of the weaknesses in the line-of-business test.”³⁴

Assuming a Corporate Opportunity Exists, what Are the Fiduciary’s Obligations?

Should a disputed prospect constitute a corporate opportunity, the fiduciary has essentially two choices: she may either (a) abstain altogether from appropriating it,³⁵ or (b) promptly disclose the existence and essential terms of the project—along with her personal interest in it—to the corporation, and hope that the corporation rejects it. By effectively requiring disclosure, the doctrine effectively grants the corporation an implied right of first refusal on the project. Accordingly, most jurisdictions specify procedural protocols by which the corporation may reject a disclosed opportunity, thereby empowering the fiduciary once again to pursue it individually.³⁶

A theme that permeates the disclosure cases is that only *full* disclosure of all relevant details of the project and the fiduciary’s interest enables the corporation to make an informed decision about whether to reject the opportunity.³⁷ Most cases hold that absent complete disclosure a later rejection is voidable by the corporation or its shareholders.³⁸ Moreover, in many

property and the nature of the corporate business” (quoting *Johnston v. Greene*, 121 A.2d 919, 924 (Del. 1956) (alteration in original)).

³³ See *Miller v. Miller*, 222 N.W.2d 71, 81 (Minn. 1974). Under the *Miller* two-part test, the first step is to determine whether the disputed project is sufficiently related or of special importance to the corporation to justify sanctions against appropriation. If so, then the inquiry proceeds to determine whether the appropriating fiduciary violated the duty of loyalty and fair dealing she owed to the corporation. See *id.*

³⁴ *Northeast Harbor Golf Club*, 661 A.2d at 1150.

³⁵ See *Dunaway v. Parker*, 453 S.E.2d 43, 51 (Ga. App. 1994).

³⁶ These procedures are usually similar to those necessary to “cleanse” any other interested transaction. See, e.g., ALI PCG § 5.05 cmt. a (1994) (noting that disclosure and rejection doctrine for the COD are similar to those of § 5.02). For a good description of Delaware law on self-dealing transactions under DEL. GEN. CORP. L. § 144, see *In re Wheelabrator Technologies Shareholders Litigation*, 663 A.2d 1194, 1201-03 (Del. Ch. 1995). For California, see CAL. CORP. CODE § 310 (1999).

³⁷ One court has described the full-disclosure requirement thus:

[I]f the doctrine of business opportunity is to possess any vitality, the corporation or association must be given the opportunity to decide, upon full disclosure of the pertinent facts, whether it wishes to enter into a business that is reasonably incident to its present or prospective operations. If directors fail to make such a disclosure and to tender the opportunity, the prophylactic purpose of the rule imposing a fiduciary obligation requires that the directors be foreclosed from exploiting that opportunity on their own behalf.

Kerrigan v. Unity Savs. Ass’n, 317 N.E.2d 39, 43-44 (Ill. 1974). Full disclosure plays a central role in the ALI test as well. See ALI PCG § 5.05(a) cmt. (“If the opportunity is not offered to the corporation, the director or senior executive will not have satisfied § 5.05(a).”).

³⁸ See *McCabe Packing Co. v. United States*, 809 F. Supp. 614, 617 (C.D. Ill. 1992) (“Under Illinois law, the business decision of a corporation not to engage in a particular line of business is

jurisdictions a failure to disclose important characteristics of the project can also render a number of potential defenses unavailable (see below), and it may even toll the statute of limitations.³⁹

Once a Fiduciary Discloses, What Must/May the Corporation Do?

Importantly, full disclosure to the corporation does not, *ipso facto*, entitle the fiduciary to pursue a business prospect personally. Much to the contrary, the fiduciary must still wait for the corporation to “reject” the opportunity. The process of rejection typically follows a procedure similar to that in more generic conflict-of-interest contexts, such as (1) approval or ratification by either an affirmative vote of the disinterested directors, (2) approval or ratification by the disinterested shareholders,⁴⁰ or (3) in the case of a senior executive, approval by a disinterested superior.⁴¹ While formalized acts of rejection (such as a formal vote of disinterested directors) have been held to be a type of “safe harbor,” even in their absence a disclosing fiduciary may still be able to demonstrate rejection by demonstrating that the corporation informally rejected the opportunity⁴² or that appropriating the opportunity was nonetheless “fair” to the corporation.⁴³

If Liability is Found, What Is/Are the Applicable Remedies?

The remedy for appropriation of a business opportunity can be either legal or equitable, depending on the case, though the general preference appears to be the latter. Consequently, unlike other commercial settings, the monetary remedy in most corporate opportunity cases tend to be gains-based rather than harm-based in nature.⁴⁴ In fact, the presumptive remedy for such a

beyond any questioning by the courts, as long as the corporation was given the opportunity upon full disclosure of the facts to decide whether to enter the particular line of business.”); *Havlicek/Fleisher Enters. v. Bridgeman*, 788 F. Supp. 389, 395 (E.D. Wis. 1992) (“Without full disclosure, an informed acceptance or rejection of a corporate opportunity cannot be made.”); *Castleman ex rel. Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 437 (Del. 1996).

³⁹ See 3 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 861.1, at 285 (perm. ed. rev. vol. 1994) (“[M]ere disclosure of the transaction, without revealing the surrounding circumstances, is not sufficient, and failure to make complete disclosure constitutes constructive fraud, thereby tolling the statute of limitations.”).

⁴⁰ ALI PCG § 5.02(a)(2)(d).

⁴¹ See Del. Gen. Corp. L. § 144(1); ALI PCG § 5.05(a)(3)(B) (taking a corporate opportunity is acceptable if the disinterested directors reject the opportunity “in a manner that satisfies the standards of the business judgment rule”).

⁴² *Broz v. Cellular Information Systems*, 673 A.2d 148 (Del. 1996), *rev’g* 663 A.2d 1180 (Del. Ch. 1995).

⁴³ See ALI PCG § 5.05(c) cmt.

⁴⁴ See *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir. 1994) (“[B]reaches of a fiduciary relationship in any context comprise a special breed of cases that often loosen normally stringent requirements of causation and damages.”); see, e.g., *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del. 1996) (“Once disloyalty has been established, [Delaware law] require[s] that a fiduciary not profit personally from his conduct, and that the beneficiary not be harmed by such conduct.”); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (“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

breach is the imposition of a constructive trust on the disputed enterprise, effectively disgorging all of the fiduciary's verifiable profits (even if they exceed the corporation's provable loss, and even if there is *no* provable loss⁴⁵). It is nevertheless common for courts to reserve some portion of the profits for the breaching fiduciary, as compensation for services rendered in overseeing the disputed opportunity.⁴⁶

In cases where the appropriation is deemed to be particularly malicious, oppressive, or in bad faith, punitive damages may be available as well. But beyond this distinction, most courts appear to inquire very little about the *path* the fiduciary followed in breaching her duty. In terms of Figure 1, a fiduciary might have breached by completely failing to disclose (node X_1) or by disclosing but failing to secure proper rejection before pursuing the project (node X_2). Regardless of this path, most courts tend to impose a constructive trust on a breaching fiduciary as a default measure of damages. The likelihood of punitive damages, however, appears to be greater for appropriation following nondisclosure than it is for appropriation following full disclosure but absent refusal by the firm.⁴⁷

Are there Any Defenses?

Over the years, courts have crafted a few important affirmative defenses to a COD action. Three of the most salient are the so-called “source” rule, the “incapacity” defense, and the doctrine of “implied refusal.” The first two of these defenses have the effect of neutralizing the determination that a disputed project was a corporate opportunity to begin with. The final defense has the effect of substituting for an express rejection of the opportunity by the corporation.

1. The “Source” Rule

A number of jurisdictions permit a limited defense to a fiduciary who can demonstrate that a proffered business opportunity came from a source that was attracted to her *personal* skill, reputation and expertise, and not those of the corporation. The ALI Principles, for example, which adopt just such an approach alongside the line-of-business test, state that a corporate opportunity constitutes any new business prospect that a director: (1) learns of in her corporate capacity; (2) has reason to know is being offered to the corporation; or (3) acquires through the use of corporate information or property, if the fiduciary has reason to know that the corporation would be interested in the prospect.⁴⁸ Notably omitted from this definition is that class of business prospects that are offered to the fiduciary in her personal capacity, and not acquired through use of corporate assets or information – a category that fiduciaries have sometimes been able to

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.”).

⁴⁵ See 76 AM. JUR. 2D, *Trusts* § 232 (1992); 18B AM. JUR. 2D, *Corporations* § 1772 (1985) (noting that liability can obtain even if the corporation *benefited* from the fiduciary's appropriation).

⁴⁶ See, e.g., *Energy Resources Corp. v. Porter*, 438 N.E.2d 391, 394 (Mass. App. Ct. 1982).

⁴⁷ See, e.g., *United Teachers Assocs. Ins. Co. v. MacKeen & Bailey, Inc.*, 847 F. Supp. 521, 543-44 (W.D. Tex. 1994); *Levy v. Markal Sales Corp.*, 643 N.E.2d 1206, 1221-23 (Ill. App. Ct. 1994). Moreover, the route increasingly appears to matter in the availability of the incapacity defense (see below).

⁴⁸ See ALI PCG § 5.05(b).

exploit in their own defense.⁴⁹ Nonetheless, while this source-based approach can be seen to play a role in a number of decisions, numerous commentators have leveled significant criticism at it, citing the virtual impossibility of decoupling the relative contributions of the fiduciary's private attributes as opposed to her corporate affiliation in attracting the project.⁵⁰ It has therefore proven to be of somewhat tenuous utility to defendants.

2. The "Incapacity" Defense

On a somewhat more promising front (at least for defendants), a number of jurisdictions – particularly those following the line of business test – have also embraced its negative corollary, affording an affirmative defense to an appropriating fiduciary who can argue convincingly that the corporation was somehow unable to pursue the opportunity itself.⁵¹ While the "incapacity" defense can take a number of different forms, three are most prevalent. In one strand of cases, fiduciaries have argued that the corporation was *legally* unable to pursue the opportunity (e.g., due to ultra vires concerns, existing negative injunctions, or prospective antitrust problems⁵²). In another, the fiduciaries' defense centers on the corporation's *financial* inability to exploit the business prospect (due to liquidity constraints, bankruptcy, and the like⁵³). In a third strand of cases, defendants have asserted that corporate incapacity stemmed from more *generic business constraints*, such as a lack of appropriate personnel, lack of profitability, or refusals by third parties to deal with the corporation, that rendered the project de facto unavailable to the firm.⁵⁴

On the whole, claims of legal and financial incapacity have proven significantly more effective for defendants than those claiming generic business constraints. In particular, alleged "refusals to deal" by the third party have been scrutinized most heavily in practice. Particularly troubling to courts in such cases is the problem of verifying in hindsight the third party's resolve, especially in light of the obvious incentives for both the fiduciary and the third party to make self-serving claims that such barriers were prohibitive. As such, courts are virtually unanimous in

⁴⁹ See *Central Ry. Signal Co. v. Longden*, 194 F.2d 310, 319 (7th Cir. 1952); *Guth v. Loft, Inc.*, 5 A.2d 503, 511 (Del. 1939).

⁵⁰ See, e.g., CLARK, *supra* note 4, at 230 ("The distinction between official and individual capacities can create endless argument about the proper characterization of facts. . . . [I]t is often difficult to decide when an executive has stepped completely outside of his role."); see also David Clayton Carrad, *The Corporate Opportunity Doctrine in Delaware: A Guide to Corporate Planning and Anticipatory Defensive Measures*, 2 DEL. J. CORP. L. 1, 2 (1977) (noting the difficulty of clearly demarcating the fiduciary's role).

⁵¹ See, e.g., *Castleman ex rel. Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 443 (Del. 1996) ("[T]hose transactions which were not economically rational alternatives [for the corporation to pursue] need not be considered by a court evaluating a corporate opportunity scenario.")

⁵² See *Borden*, 530 F.2d at 493; *Alexander & Alexander v. Fritzen*, 542 N.Y.S.2d 530, 535 (App. Div. 1989); *Urban J. Alexander Co.*, 224 S.W.2d at 928. Despite the sporadic success of such arguments, courts are increasingly limiting the incapacity defense only to cases where the fiduciary fully discloses but does not receive proper rejection before appropriating. See, e.g., *Demoulas*, 677 N.E.2d at 181.

⁵³ See *Borden v. Sinskey*, 530 F.2d 478, 493 (3d Cir. 1976); *Thorpe*, 676 A.2d at 443; *Broz v. Cellular Info. Sys.*, 673 A.2d 148, 155 (Del. 1996); *Northeast Harbor Golf Club*, 661 A.2d at 1149; *Urban J. Alexander Co. v. Trinkle*, 224 S.W.2d 923, 928 (Ky. 1949).

⁵⁴ See *Energy Resources Corp. v. Porter*, 438 N.E.2d 391, 394 (Mass. App. Ct. 1982).

restricting the refusal-to-deal defense to those situations where the fiduciary has fully disclosed, so as to “test” the nature of the incompatibility between the third party and the corporation.⁵⁵

3. *Implied Rejection*

An interesting special case for the COD involves situations where the fiduciary has disclosed the opportunity, but the corporation fails to act. A few jurisdictions have developed what amounts to a doctrine of “implied refusal” for such situations, allowing the fiduciary to pursue the opportunity if the corporation does not act upon it within a reasonable time following disclosure. Defendants generally have been successful in such cases only when they argued that they acted in good faith by fully disclosing and did not use other corporate assets in pursuing the opportunity.⁵⁶ Once again, however, there is a veritable dearth of case law that deals squarely with the (so-called) implied rejection doctrine, and its general viability remains both uncertain and disputed.⁵⁷

Is it possible to “contract out” of the doctrine?

Because the COD is a subspecies of the fiduciary duty of loyalty, it is historically treated as an equitable doctrine. Perhaps accordingly, some courts have expressed skepticism of private attempts to alter or limit such duties contractually. Indeed, notwithstanding the fact that most states now have exoneration statutes that permit corporations to limit or eliminate liability for breaching fiduciary duties through their charters, these same statutes also expressly exclude the fiduciary duty of loyalty from their application.⁵⁸ As such, the practice of weakening the reach of the COD through contracts, bylaws, or charter provisions has often been thought suspect by both

⁵⁵ See, e.g., *Regal-Beloit Corp. v. Drecoll*, 955 F. Supp. 849, 863 (N.D. Ill. 1996) (noting that in the absence of disclosure, it is impossible to test a fiduciary’s assertion that a corporation could not pursue an opportunity because of a third party’s refusal to deal); *Energy Resources Corp.*, 438 N.E.2d at 394 (rejecting a refusal to deal defense and stating that “[w]ithout full disclosure, it is too difficult to verify the unwillingness to deal and too easy for the executive to induce the unwillingness”); *Production Finishing Corp. v. Shields*, 405 N.W.2d 171 (Mich. Ct. App. 1986); *Imperial Group, Inc. v. Scholnick*, 709 S.W.2d 358 (Tex. Ct. App.—Tyler 1986, writ ref’d n.r.e.). In fact, in some jurisdictions courts have been sufficiently troubled by verifiability problems to disallow the incapacity defense *altogether*, effectively requiring the insider to tender any opportunity about which she learns as a result of her affiliation with the corporation. See, e.g., *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2d Cir. 1934); *Kerrigan v. Unity Sav. Ass’n*, 317 N.E.2d 39 (Ill. 1974).

⁵⁶ See, e.g., *Lussier v. Mau-Van Dev.*, 667 P.2d 804 (Haw. Ct. App. 1983); *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940); *Farber v. Servan Land Co.*, 662 F.2d 371 (Former 5th Cir. 1981); *CST, Inc. v. Mark*, 520 A.2d 469 (Pa. Super. Ct. 1987).

⁵⁷ Compare ALI PCG §5.05(a) cmt. (requiring that the corporation “promptly” accept or reject the opportunity once it has been disclosed and offered, and that failure to accept the opportunity within a reasonable time will amount to a rejection of the opportunity), *with* 18B AM. JUR. 2D *Corporations* § 1788 (1985) (stating that “[t]he corporation’s unwillingness to take advantage of the opportunity in question must be *clearly manifested*” (emphasis added)).

⁵⁸ See DEL. CODE ANN. tit. viii, § 102(b)(7) (1996). A majority of other states have similar limitations, including California, CAL. CORP. CODE § 204(a)(10)(iii) (West 1990).

courts and commentators.⁵⁹ On the other hand, it is difficult to ignore the fact that in most jurisdictions, the very definition of a “corporate opportunity” (see above) turns on the current and prospective interests and expectancies of the corporation – factors which depend in part on the firm’s contractual dealings and corporate governance structure.⁶⁰ As such, the legitimacy of express efforts to limit the application of the COD has remained extremely uncertain.

Delaware has recently attempted to address this uncertainty by amending the Delaware General Corporation Law. Along with other, unrelated amendments,⁶¹ the General Assembly added an additional paragraph to Section 122, which now reads (in relevant part):

§ 122. Specific Powers

Every Corporation created under this chapter shall have power to –

...

(17) Renounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or one or more of its officers, directors or stockholders.

This amendment is the first of its kind in the United States, and it has potentially far-reaching implications.⁶² Most importantly, this amendment apparently resolves the uncertainty surrounding the advance renunciation of the COD in favor of general permissiveness and contractual flexibility. It does so, however, in a manner that carries at least three important caveats that counsel should keep in mind.

First, the amendment emphasizes that any advanced renunciation of the doctrine must be related to *specified* opportunities, or classes/categories thereof. As such, the statute does not appear to permit sweeping renunciations that apply to all opportunities, classes and categories *writ large*, but instead appears to be limited to specific “carve outs” through express action of the corporation. Given the common-law history of the COD, it is reasonable to expect that courts will tend to construe such carve outs narrowly, resolving ambiguities in favor of the corporation.

⁵⁹ See, e.g., Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 743 (1992) (opining that the COD may be a type of “one-way” default rule, permitting parties to enhance the fiduciary’s minimal duties, but not to weaken them.); *Siegmán v. Tri-Star Pictures, Inc.*, 15 Del. J. Corp. L. 218, 238 (Del. Ch. 1989) (finding that a charter amendment limiting the reach of the COD would “arguably operate to eliminate or limit the directors’ liability for breach of their duty of loyalty”).

⁶⁰ Indeed, there is some authority to support the proposition that parties have some limited ability to modify the COD contractually, *not* by limiting damages, but instead by crafting an express definition of a “corporate opportunity.” See, e.g., *American Inv. Co. v. Lichtenstein*, 134 F. Supp. 857 (E.D. Mo. 1955) (permitting a corporation to adopt a policy excluding a certain activity from the operation of the COD); see also ALI PCG § 5.05(a) (allowing certain opportunities to be rejected in advance by the corporation).

⁶¹ For an overview of the all the recent amendments, see Lewis S. Black and Fredrick H. Alexander, *Analysis of the 2000 Amendments to the Delaware General Corporation Law* (Aspen Law & Business, 2000).

⁶² Although the amendment does not radically and unambiguously alter existing doctrine considerably, it goes a long way in clarifying whether the COD is a default or immutable rule.

Second, while the statute allows for renunciation of opportunities through the corporate charter, it also permits renunciation “by action of [the] board of directors.” Such action could conceivably include a by-law amendment (if feasible by action of the board), or even the holding of a less formalized vote among the directors or authorized subcommittee thereof. Nevertheless, the legislative history and synopsis of the amendment clearly reflects the Assembly’s view that the board must comply with its fiduciary duties when acting to renounce corporate opportunities. This caveat suggests that it would probably be most prudent for Delaware corporations to renounce opportunities before a conflict arises, preferably at the time of formation if feasible.⁶³

Finally, while the amended Section 122 permits corporations to alter the definitional categories that give rise to *liability*, the text of the section does not directly bear on contractual modifications of the *remedy* resulting from misappropriation of corporate opportunities (however defined). Here, it is likely that courts will continue to use their discretion to fashion their own remedies for breach, as discussed above.

Special Challenges for Transitional Economies

As the above discussion demonstrates, American courts and legislatures have had an extremely difficult time promulgating and enforcing a doctrine that is simultaneously nuanced and predictable. The current landscape has led many US legal scholars (including myself) to advocate a restructuring of the doctrine,⁶⁴ moving toward a set of proscriptions that are both more categorical than the status quo ante, and ones that rely on more administrable sanctions (such as injunctions, or untailed “liquidated” damages for breach). It is somewhat ironic, then, that at least some European legal scholars have advocated moving toward the same American model that has proven so unwieldy and intractable in practice.⁶⁵

Notwithstanding whether one ultimately believes that *developed* countries should move toward a more (or less) nuanced doctrine, however, a US-style system of corporate opportunity regulations might prove particularly inaccessible and imprudent to *developing* nations. Indeed, four conditions that are frequently manifest in developing economies pose significant dangers for a nuanced US-style approach. I briefly address them each in turn.

Centralized Ownership. It is now widely recognized that ownership structures in transitional economies are, like much of Western Europe, highly concentrated (in comparison to American ownership structures). This concentration of control is likely a necessity in developing countries, where the ability to generate revenue is highly tied to entrepreneurship skills.⁶⁶ But assuming (for current purposes) that such ownership concentrations are necessary, a US-style COD would be extremely difficult to implement. Indeed, when ownership is concentrated, it becomes virtually impossible to create the type of organizational firewalls within a board of directors that would produce a truly disinterested set of board members when a conflict of interest arises. Indeed, most (if not all) board members are likely to be controlled (either directly or by

⁶³ This point is particularly salient in the context of a parent who sells off a portion of its subsidiary in order to raise capital. By placing an express renunciation in the subsidiary’s charter, the parent can avoid an inevitable conflict of interest that would occur should it attempt to cause the subsidiary to renounce an opportunity after selling off the minority stake.

⁶⁴ See, e.g., Talley, *supra* note 3.

⁶⁵ See, e.g., Lowrey & Edmunds, *supra* note 1.

⁶⁶ See Roman Frydman et al., *Private Ownership and Corporate Performance: Some Lessons from Transition Economies*, World Bank Working paper 1830 (1997).

thin implication) by the dominant shareholder, who is frequently the individual that is interested in pursuing the opportunity. As such, any act that purports to constitute “disinterested” rejection of an opportunity by the corporation becomes suspect. Moreover, inaction on the part of a board after disclosure by a fiduciary is unlikely to create a reasonable inference of rejection (as it often does in a number of US jurisdictions).

Thin Capital Markets. A second frequent characteristic of transitional economies is that public equities markets are relatively illiquid and thin. Given the concentration of ownership structures, this observation should not be terribly surprising, as the rate trade volume for such firms must be lower than their widely held counterparts. But the illiquidity of such markets also means that capital markets are unlikely to provide much augmenting discipline against managerial mischief. In other words, the liquid capital markets in the US provide an important safety net for legal doctrine: the rules regulating corporate opportunities, therefore, can afford to be under-inclusive when market forces stand by to provide other types of sanctions. When capital markets are unreliable, however, fiduciary obligations must necessarily do more of the work. As such, the optimal balance between over- and under-inclusiveness is likely to be struck at a very different location, and would likely be more draconian and categorical in nature.

Executive Compensation. A third feature of transitional economies is the modest compensation that corporate executives receive relative to their US counterparts.⁶⁷ Indeed, until the late 1990s, stock-based compensation for corporate executives in the developing world was virtually nonexistent, and it is still relatively rare.⁶⁸ On first blush, perhaps, a permissive corporate opportunity doctrine might actually constitute a way to provide incentives to corporate executives. Indeed, the ability to appropriate new business prospects may provide just the type of incentives that induce corporate executives to work hard at generating business. At the same time, however, the temptations posed by the appropriability of firm property are likely too large to be resisted by most corporate executives. Anticipating this vulnerability, a corporate fearing later appropriation may ration its managerial positions, or be forced to pay extremely supra-competitive executive salaries which may not be feasible in many developing countries.

High Uncertainty. Finally, transitional economies are highly dynamic, fluctuating environments. The line of business of a firm may change radically during its lifetime, and its requisite needs and expansion opportunities are unlikely to remain stable. This unpredictable environment poses particular challenges for any corporate governance system that rests, even in part, on a contractarian account of the firm. The transaction cost of contemplating and accounting for every future contingency in a corporate charter (or initial set of bylaws) is oftentimes staggering. But it is this very ability to contract out of the default COD that animates much of US law on the topic. Indeed, as noted above, Delaware now allows corporate charters either to expand or contract the universe of prospects that constitute bona fide corporate opportunities, and a number of companies routinely do so. When this type of ex ante contracting is difficult or impossible to execute, the underlying legal rule is left to carry a greater proportional role. As such, the stakes are perhaps much greater for transitional economies to get the doctrine “right” from the start. Given the underlying contextual differences noted above in developing countries, it seems sensible to favor a corporate opportunity doctrine that is both less forgiving and more immutable than the norm in US jurisdictions.

⁶⁷ See, e.g., Bebchuk, Fried & Walker (2001) (reviewing evidence).

⁶⁸ See Mathiesen (1995).

Conclusion

Vita Sackville West wrote in a recent gardening book, “It isn’t that I don’t like sweet disorder, but it has to be judiciously arranged.” Similarly, those who would design corporate governance schemes in developing countries frequently find themselves in the position of arranging a type of sweet economic disorder. Although the case of corporate opportunities is but a single example in this larger enterprise, the discussion above illustrates that simple emulation of nuanced governance doctrines from the US (or other developed economy) may be particularly inappropriate in the context of a transitional economy.