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# Corporations - Doctrine of Corporate Opportunity

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## CORPORATIONS — DOCTRINE OF CORPORATE OPPORTUNITY

Legal doctrines insofar as they constitute endeavors to define criteria of conduct upon which legal consequences can be determined have served a useful purpose in the law. The doctrine of corporate opportunity, as adopted by the court in *Guth v. Loft*,[1] attempts to lay down certain guides to aid in determining whether a director, officer or manager of a corporation is violating his fiduciary duty in engaging in a business competing with that of the corporation of which he is a director, officer or manager.

The general rule is, where the business is definitely a competing business with that of the corporation, the directors are not *per se* prohibited from engaging in the competing business providing they are in good faith and the competing business does not cripple or hinder or injure the business of the corporation.[2] A simple example is found in a California case[3] in which the court granted an injunction and damages where a director of a florist corporation aided in the financing of a new florist concern, worked for it and solicited plaintiff's customers for sales by the new concern. Also the *Red Top Cab*[4] case where the court imposed a trust for the benefit of the corporation on profits arising from a cab business organized by defendant, director and managing agent of the plaintiff corporation, likewise engaged in the cab business, and where defendant director used the employees and facilities of plaintiff corporation in the competing business. The theory behind these cases is that while a director is not strictly a trustee, he occupies a fiduciary relation to the corporation and its stockholders and his acts must be for the benefit of the corporation and its stockholders and not for himself. He cannot enrich himself at their expense.[5]

While it may be objectively determinable whether the competing business does or does not cripple or injure the business of the corporation, the question of good faith, involving as it does a subjective determination, is more difficult to ascertain.[6] Thus it would seem that a standard containing determinable factual elements capable of objective application would more adequately and practically solve the pertinent issue: "Is the particular business opportunity involved one which the director may appropriate to himself without the violation of his fiduciary relation to his corporation?"

[1] Guth v. Loft, 23 Del. Ch. 255, 5 A.(2d) 503 (1939).
[2] 19 C.J.S. 785; Bump Co. v. Waukesha Foundry Co., 238 Wis. 643, 300 N.W. 500 (1941).
[3] Hall v. Dekker, 45 Cal. App. 783, 115 P. (2d) 15 (1941).
[4] Red Top Cab Co. v. Hanschett, 48 F. (2d) 236 (1931).
[5] Golden Rod Mining Co. v. Bukvich, 108 Mont. 569, 92 P. (2d) 316 (1939).
[6] Although it would seem the appropriation by the director of the corporation's facilities etc., would constitute an important factor in determining good faith.

The purpose and scope of this article is to discuss the elements of the doctrine of corporate opportunity together with an analysis of the interpretation and application of each element as made by the courts both before and after the decision of *Guth v. Loft.*

The definition of corporate opportunity is presented in *Guth v. Loft* as merely one of the manifestations of the general rule that demands of corporate officers or directors the utmost good faith. To determine whether a business opportunity is one which the director or officer can appropriate the court laid down the the elements discussed below. If these elements are established in a given case the enterprise is one which the law will not permit the officer or director to seize for himself.

1. The corporation is financially able to undertake the business opportunity presented. There is a conflict of authority on this point as presented in other cases. In *Pioneer Oil & Gas Co. v. Anderson*[7] the court declined to apply the doctrine of corporate opportunity because the corporation was not in a position to take advantage of the enterprise due to three factors: the financial inability of the corporation; the unwillingness of the third party to deal with it in the prior negotiations made by the corporation for the purchase of the land involved; the inadvisibility of the venture. In contradistinction is *Irving Trust Co. v. Deutsch*[8] which held that the directors could not appropriate the opportunity to themselves even where it is shown that the corporation is financially unable to purchase. This case can be distinguished, however, on the ground that had the director paid his indebtedness to the corporation, the latter would have been financially able to adopt the opportunity. In justification of its decision the court said that if the strict rule were not followed the directors would be tempted to refrain from exerting their best efforts to obtain financial aid for the corporation because of the conflict of interest presented.

2. The business opportunity is, from its nature, in the line of the corporation's business. That this element is clearly capable of ascertainment is shown in the situations where the opportunity was held not to be in the line of the corporation's business and consequently permissible for the directors or officers of the corporation to engage in.[9]

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[7] Pioneer Oil & Gas Co. v. Anderson, 168 Miss. 334, 151 So. 161 (1933).

[8] Irving Trust Co. v. Deutsch, 3 F.(2d) 121 (2d cir., 1934).

[9] Broderick v. Blanton, 59 N.Y.S. (2d) 136 (1945), directors of corporation bought on their own bulk whisky in barrels for speculation whereas the plaintiff corporation was engaged in distilling and bottling liquor for sale to customers as its own product and unless absolutely necessary did not sell liquors manufactured by others, and when it did bought for use and not speculation. Also Lancaster Loose Leaf Tobacco Co. v. Robinson, 199 Ky. 313, 250 S.W. 997 (1923), where the tobacco company had never engaged in the business of buying tobacco from farmers, the president of the company was allowed to buy tobacco from farmers on his own account; Diedreick v. Helm, 217 Minn. 483, 14 N.W. (2d) 913 (1944), where directors of a building and loan association were permitted to buy stock in an insurance agency

3. The business opportunity is of practical advantage to the corporation. Clearly illustrative of this factor is *Turner v. American Metal Co.*[10] which held that the directors of the plaintiff corporation were not liable for purchasing an interest in a new corporation organized to operate an enterprise dealing with a newly discovered alloy, when at the time the alloy was not established as a scientific reliable product and it was consequently of no practical advantage to the plaintiff corporation to undertake this enterprise at the time. The court went on to say that no corporate opportunity was present because the enterprise was not an expansion of any existing department of the plaintiff corporation, but a new industry, for which the plaintiff corporation did not have the fundamental knowledge or practical experience with which to exploit the venture. There was present no inherent aptitude of being intergrated into the existing business of the corporation.

4. The business opportunity is one in which the corporation has an interest or reasonable expectancy. Of all the elements this particular one is most susceptible to varied interpretations as evidenced by the decisions. In the *Colorado Utah Coal Co.*[11] case the court held that no corporate opportunity was violated when the defendant director secretly purchased coal land although there was evidence that the plaintiff corporation was investigating and considering the purchase of the property in question in addition to extensive investigations as to numerous other coal lands. Holding that the burden is on the plaintiff to establish expectancy, the court said it was bound to establish not only that the property in question possessed value to it, but that it had a practical, not a mere theoretical use therefor. Here the plaintiff corporation was operating in a territory of unlimited extent and if the doctrine of expectancy was extended to cover this territory, plaintiff would have a virtual monopoly in this territory. In another case[12] involving the purchase of lands, the director purchased an interest in certain lands in which the plaintiff corporation had an existing lease of a one-third interest, a contract to purchase a one-third interest, and had been negotiating for purchase of the remainder of the property. In holding that the director could not oust the corporation from beneficial property rights the court would not permit the director to interfere with

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which sold insurance to borrowers of the plaintiff building and loan association because interpretation of the law prohibited the association from acting as an agent in receiving premiums on insurance as did also a by-law of the association. The court said that where a corporation declines because of legal barriers or it is the settled policy of the corporation not to engage in the particular business, the directors may engage in that field. For examples of competing business in line with the corporation's business see Hall v. Dekker, *Supra,* Note 3; Red Top Cab Co. v. Hanschett, *Supra,* Note 4.

[10] Turner v. American Metal Co., 268 App. Div. 239, 50 N.Y.S. (2d) 800 (1944).

[11] Colorado Utah Coal Co. v. Harris, 97 Col. 309, 49 P. (2d) 429 (1935).

[12] Legarde v. Anniston Lime & Stone Co., 126 Ala. 496, 28 So. 199 (1900).

the interest in the lease and the existing contract on the ground of the presence of a reasonable expectancy attending these interests. However, the court goes on to say there is no expectancy of value when a corporation has been negotiating and endeavoring to purchase. "Legal restrictions on officers or directors in their acquisitions are generally limited to property wherein the corporation has an interest already existing, or in which it has an expectancy growing out of an existing right." A current problem is exemplified in *Lincoln Stores v. Grant*[13] where defendant directors purchased and operated a store similar in nature to the branch store operated by plaintiff corporation across the street. In developing the business of the new store they used plaintiff's records, inventories, and charged traveling expenses to the plaintiff's corporation as two of the directors maintained their positions with the plaintiff corporation while one resigned to operate the new store. Several years before, the corporation had considered acquiring additional floor space for the corporation's stores but decided it was not feasible at the time and later decided not to take an option whereby they could have secured this objective in different premises. The court refused to impose a constructive trust on the stock of the defendants in the new store because the corporation did not show any interest in or need the store—in the words of the court—the corporation had no interest or expectancy in the store as its acquisition had never been considered and they were no longer interested in acquiring additional floor space at this time. The court, however, decreed damages on profits lost due to the competing business and ordered a refund of the paid expenses and salaries.[14]

It has been said that the *Guth v. Loft* decision goes farther than most decisions in holding the doctrine of corporate opportunity to apply where there is an opportunity to expand or increase the present business. Whereas other decisions only apply the doctrine where the opportunity is essential to the existence of the corporation and are reluctant to apply it where the opportunity does not have a close and peculiar relationship to the immediate corporate interests and needs.[15]

5. The business opportunity when embraced by the officer or director will cause the self-interest of the latter to be brought into conflict with that of the corporation. This point is self-evident based as it is on the basic rule of human nature that no man can serve two masters.

In order to more comprehensively understand the practical application of the doctrine of corporate opportunity to a given set of circumstances it might be well to consider specifically the facts in *Guth v. Loft*.

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[13] Lincoln Stores v. Grant, 309 Mass. 417, 34 N.E. (2d) 704 (1941).

[14] This decision is criticized in 55 Harv. L. Rev. 866-8 on the ground that a constructive trust remedy should have been applied.

[15] 31 Calif. L. Rev. 188-99.

The Loft Company, a corporation engaged in manufacturing and selling candies, beverage syrups and foodstuffs, wholesale and retail, manufactured all their own syrups, but coca-cola, which they jobbed from the Coca-Cola Company. Guth, a director of Loft Company, who controlled Loft's board of directors, suggested replacing coca-cola syrup with another which could be purchased at a lower price. One possibility was pepsi-cola syrup. The Pepsi-Cola Company, however, was bankrupt, but Guth and another formed a new corporation to acquire the pepsi-cola formula and trademark for the manufacture and sale of that product. Guth drew at one time on almost the entire working capital of the Loft Company, used Loft's plant, facilities, materials, credit, executives and employees. The payroll sheet of the new corporation was a part of Loft's and a single Loft check was drawn for both. No charge was made for the use of the plant, facilities and service rendered by the executive, high ranking employees and chemist. At all times Loft Company was able to finance the project. Due to its discontinuance of coca-cola it spent large amounts in advertising this new product and suffered losses of profits at its stores from the discount of coca-cola. The new company formed by Guth sold the pepsi-cola product to Loft Company, one of its customers, at a profit.

The pertinent elements supporting the decision rendered in *Guth v. Loft* can be briefly summarized as follows:

1. Loft Company possessed sufficient assets to finance the enterprise.
2. Loft Company possessed the plant equipment, executives, personnel and facilities, all of which were adequate supplies by expansion for the necessary development of the business.
3. Loft Company was engaged in the manufacture of syrups and with the exception of a cola syrup supplied its own needs.
4. Loft Company did have an interest or expectancy in the Pepsi-Cola business as it was a necessity to sell and acquire a cola drink as it had stopped selling coca-cola.
5. A conflict of duty was created by the director, Guth, in his dual capacity of controlling the supply of pepsi-cola and determining his price and terms so that in offering pepsi-cola to Loft Company, he also had the power as Loft to accept. In the words of the court "he made himself a judge in his own cause."
6. In the manufacture of pepsi-cola, Guth used at one time the entire working capital of Loft Company.
7. Guth used Loft's plant, facilities, materials, credit, executives and employees.

As with any legal doctrine or theory the doctrine of corporate opportunity is no exception to the inevitable practice of subjection to various interpretations and applications. However, one cannot but help observe that the distinctions found (as shown in the cited cases) can almost always be justified by the peculiar facts involved there. The merits of the doctrine of corporate opportunity are self-evident. To the enterprising director and to the attorney advising his director or corporate client the doctrine of corporate opportunity as enunciated in *Guth v. Loft* establishes a veritable legal guidepost.

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