The Corporate Opportunity Doctrine and Impossibility Arguments

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This article considers whether English law should allow a director to argue that if the company is unable to exploit a corporate opportunity, the director should be free to exploit it personally. The article supports the view of the Company Law Review Steering Group that the answer should remain no. In so doing it analyses US practice to show that, even where such arguments are recognised, they are difficult to prove and their potential application is curtailed through the development of satellite rules. Indeed, in practical terms there may be no significant difference between the Steering Group’s recommendations and the position towards which US law appears to be moving.

Introduction

Should a business opportunity, incapable of exploitation by a company, be regarded as that company’s opportunity and, as such, be unavailable for unauthorised exploitation by a director thereof? This was one of the many questions raised by the Company Law Review Steering Group.1 It is not a new question. The orthodox answer given in Regal (Hastings) Ltd v Gulliver2 is that a company’s opportunity does not cease to be so merely because the company is unable to exploit it, for example because the company is unable to finance the opportunity’s acquisition.3 In so doing the court followed the approach established in Keech v Sandford.4

As evidenced by the responses to the Steering Group’s Consultation documents – Developing the Framework5 and Completing the Structure6 – the orthodox answer retains considerable support7 (including the support of the Steering Group8 and

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2 [1967] 2 AC 134n.
4 (1726) 25 ER 223.
5 The Company Law Review Steering Group, Modern Company Law for a Competitive Economy, Developing the Framework DTI Pub URN 00/656 (March 2000).
6 Completing the Structure, n 1 above.
7 For example Arthur Anderson responded: '[w]e do not see it as a responsibility of company law to protect directors from personal loss through not being able to exploit opportunities outwith their roles as company directors.' Response of Arthur Anderson to Completing the Structure, ibid, as contained in Responses to the Consultation Document 'Completing the Structure,' Corporate Governance: Scope (Chapter 3) doc 93 at http://www.dti.gov.uk/ckd/reviews.comple-
answ.htm (last visited 12 August 2003).
8 The Company Law Review Steering Group, Modern Company Law for a Competitive Economy, Final Report DTI Pub URN 01/942 and URN 01/943 (June 2001) 3.22–3.27.

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the Government\(^6\)). Reform is seen as better achieved through conferring an ability on the board\(^10\) to authorise the director’s exploitation of the opportunity. But, just as the result in *Regal (Hastings)* attracted criticism,\(^11\) so does the orthodox answer. Representative of this is the following negative response to the Steering Group – that ‘[n]ot to allow directors to chase such opportunities ... [is] damaging to entrepreneurial activity.’\(^12\) This respondent also suggested that a director should be allowed to exploit an opportunity if he or she can show that the company ‘would not’ have done so ‘at the time.’\(^13\)

While the debate on what can be called ‘the impossibility argument’ is just one aspect of the wider question, ‘when is a business opportunity an “opportunity of the company”?\(^14\) it is an important aspect. Not only does it help define the ambit of what constitutes a company’s opportunity but it also invites consideration of the role of directors.

Delaware law provides some support for advocates favouring adoption of an impossibility argument. Delaware is the ‘leading’\(^15\) US state for the incorporation of public companies\(^16\) and its case law has been described as ‘probably the richest.’\(^17\) *Guth* v *Loft, Inc*\(^18\) is a prime example. If not the ‘quintessential’\(^19\) corporate opportunity case, *Guth* is probably the most-cited one.\(^20\) It is credited with establishing what has become the prominent US corporate opportunity test,\(^21\) the so-called line-of-business test. For many who argue that English law should recognise an impossibility argument, the line-of-business test is significant because it expressly recognizes that the company’s financial ability to acquire and develop

10 The Steering Group recommended that boards of private companies should have the ability to authorise such use unless the company’s constitution provided otherwise. But for public companies the recommendation was that the company’s constitution would have to confer this power. In both cases the board is the board acting without the participation of any interested director. This recommendation has been adopted in the draft Companies Bill, see White Paper-Draft Clauses, *ibid* Sched 2, para 6.
11 Most of the criticism has been directed to the ‘unexpected windfall’ obtained by the Company (*Boardman v Phipps* [1967] 2 AC 46, 157). See G. Jones, ‘Unjust Enrichment and the Fiduciary’s Duty of Loyalty’ (1968) 84 LQR 472, 732; Davies, n 3 above, 616.
12 Response of the Institute of Directors to the Consultation Document *Completing the Structure, Corporate Governance: Scope* (Chapter 3), doc 156, n 7 above.
13 *ibid*. See also the response of the Law Society, *ibid* doc 149.
14 This is the phrase employed by the Steering Group and carried over into the draft Companies Bill: see White Paper, n 9 above, para 3.20; White Paper-Draft Clauses, n 9 above, Sched 2, para 6.
15 D. DeMott, ‘The Figure in the Landscape: A Comparative Sketch of Directors’ Self-dealing Transactions’ (1999) 62 Law & Contemp Probs 243, 244.
16 Throughout this article when discussing US law the term ‘company’ has been used rather than ‘corporation.’
18 5 A2d 503 (Del 1939).
21 Other prominent US answers are: (i) the interest/expectancy test, see *Lagarde v Anniston Lime & Stone Co* 28 So 199 (Ala 1900); (ii) the Massachusetts’ fairness test, see *Durfee v Durfee & Canning, Inc* 80 NE2d 522 (Mass 1947); (iii) the two-step test (which combines the line-of-business test with the fairness test, see *Miller v Miller* 222 NW2d 71 (Minn 1974); and (iv) the test proposed by the American Law Institute: *Principles of Corporate Governance: Analysis and Recommendations* (St Paul, Minn: American Law Institute Publishers, 1994) (hereafter ‘Corporate Governance’) s. 5.05.
an opportunity is a relevant consideration in determining whether the opportunity should be regarded as the company’s. This is said to be ‘a welcome and realistic position [for English law] to adopt.’

Following Guth, the application of impossibility arguments gained a measure of acceptance in the US. This may have been encouraged by US adoption of the fairness, or fair-dealing, conception of corporate fiduciary loyalty, discussed below. To the extent that fairness to the company is seen as not harming the company, there is a logic in allowing a corporate fiduciary to raise arguments that the company was not harmed by the action in issue. Nevertheless, impossibility arguments remain controversial. Moreover, even in those jurisdictions that acknowledge impossibility arguments, these arguments remain difficult to prove and there is a trend towards limiting their application by the creation of satellite rules imposing disclosure and/or authorisation requirements.

To assist in the debate on whether English law should recognise impossibility arguments, this article provides a general review of US reactions to impossibility arguments. In the context of this review, the article also considers the role of directors. The intention is to negate the suggestion made by some that English law’s current rejection of impossibility arguments is a consequence of an unthinking application of the ‘ancient decision’23 of Keech v Sandford to incorporate 18th and 19th century family trust principles into company law.24 Underlying such suggestions are two inter-related arguments aimed at supporting the recognition of an impossibility argument. The first argument is that either the duty of loyalty owed by directors or the application of that duty should differ from the duty owed by other fiduciaries. The second argument is that while impossibility arguments may be inappropriate for some fiduciaries (ie the trustee of the family trust) they may be appropriate for others, in particular directors.

US law appears to support both arguments. It accepts that just as different types of fiduciary relationships attract different duties, the application of the duty of loyalty may differ between types of fiduciaries.26 Illustrating this is a recognition that the law’s response to self-dealing by corporate fiduciaries should differ from its response to other fiduciaries (such as trustees).27 Advocates of impossibility arguments gain further encouragement from the suggestion of some commentators that, underlying this development, was a concern that the strict application of traditional fiduciary principles would impede commercial activity which was motivated by corporate fiduciary self-interest.28 As was noted earlier, similar concerns were presented to the Steering Group to support the impossibility argument.

Despite these developments, there is also US recognition that impossibility arguments may be inconsistent with a director’s role, and this supports limiting the use of such arguments. Some companies (in particular public companies) depend on their directors (especially inside or executive directors) to identify and then acquire appropriate business opportunities for the company’s exploitation.

23 Discussed in the text to n 95–n 101 below.
25 Lowry and Edmunds, n 3 above, 517.
27 Discussed in the text to n 96–n 101 below.
29 Discussed in the text to n 12–n 13 above.

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In so doing, a director may be required to develop or approve strategies to overcome any difficulties preventing the company’s acquisition or exploitation of the opportunity. This practice illustrates the wider principle endorsed by the Steering Group, that the director’s role is to ‘promote the success of the company.’

The outcome of this article’s review of US reactions to impossibility arguments, and its reflections on the director’s role, is to support the Steering Group’s implicit recommendation (and its adoption by the Government) that the status of an opportunity should not depend upon whether the opportunity is capable of exploitation by the company.

Guth and the line-of-business test

Guth was the President and dominant director of Loft Inc (‘Loft’). As such, he dominated Loft’s management. Loft was primarily involved in the retail sale of candies, beverages, and foodstuffs. A smaller part of its business was manufacturing syrups for use in soft drinks, and participating in wholesale activities. The case involved Guth’s acquisition of the Pepsi-Cola formula and trademark. While Guth’s ideas of selling Pepsi in twelve ounce bottles and having licensing agreements with bottlers were important, if not crucial, for transforming Pepsi from a regional drink into a nationwide competitor for Coca-Cola, so too were Loft’s financial, manufacturing, developmental, and retailing assistance. This assistance was provided at Guth’s direction and without the knowledge or consent of Loft’s board. The court concluded that Guth’s activities constituted a breach of loyalty and, in essence, imposed a constructive trust over the Pepsi business in favour of Loft.

In so doing the court recognised that the director’s role was evolving and that this had implications for defining corporate opportunities. Prior to Guth, the prominent US corporate opportunity test had been the so-called interest/expectancy test.

The interest/expectancy test

The interest/expectancy test is attributed to Lagarde v Anniston Lime & Stone Co, and associates corporate opportunities with opportunities in which the

30 To use the language of the draft Companies Bill, see White Paper, n 8 above; White Paper-Draft Clauses, n 9 above, Sched 2, para 2.
31 Guth, n 18 above, 509.
32 ibid 505 (Loft had 115 stores).
33 ibid 515 (Guth may have been a ‘genius in his line’).
34 ibid 507 (Guth claimed credit for this idea). This size bottle was highly popular with Depression era consumers and formed the core of Pepsi’s advertising for many years. See N. McFadden, The Pepsi Generation: Fifty Year Story of Pepsi-Cola in Canada 1934–1984 (Toronto: Pepsi-Cola Canada, 1984) 9.
35 Guth, n 18 above, 506 (at one time Guth had almost all Loft’s working capital engaged in the Pepsi’s development).
36 ibid 506–507 (Loft made the syrup concentrate and prepared the directions for its mixing).
37 ibid 506 (Loft’s chemists developed the syrup).
38 ibid 507 (Loft’s stores replaced Coca-Cola with Pepsi (in the process incurring a loss of profits estimated at $300,000) and, where previously they had spent nothing on advertising, spent at least $20,000 on advertising Pepsi).
39 ibid 506.
40 Guth and a family company owned by him were ordered to transfer their shares in the Pepsi-Cola Company to Loft and account for dividends they had received.
41 n 21 above.

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855
company has some pre-existing property interest, or, to use the language of this test, opportunities in which the company has an interest or which it has a recognized expectancy of acquiring.

In Lagarde, three parties – the Anniston Lime & Stone Co, Christopher, and Martin – each owned one-third of a valuable quarry. In addition, the company had a lease of, and an option to buy, Christopher’s land. Members of the Lagarde family became stockholders in the company, and two of them were both directors and officers (ie executive directors). While they were corporate fiduciaries, the Lagardes, personally, acquired Christopher’s land. In evaluating this behaviour, the court concluded that the key question was whether the company had either ‘an interest already existing’ in those parcels of land, or ‘an expectancy growing out of an existing right’.42 Underlying this formulation was a perceived equivalence between restrictions on corporate fiduciaries acquiring opportunities personally and trustee dealings with trust property.43 Not surprisingly, given the company’s option over the land, the Lagardes were held to have breached their fiduciary obligations in purchasing the Christopher land. The result may be justified on the basis of the Lagardes’ interference with a pre-existing contractual right enjoyed by the company.44 But the court also employed property reasoning, and equated both the option and the right to renew the lease as the company’s beneficial or equitable property. Specifically, the option was regarded as creating an ‘interest’ in the Christopher land 45 and, in reasoning reminiscent of Keech v Sandford,46 the court concluded that the company, as the existing lessee, also had an expectancy in the lease being renewed.47 Both the option and lease, therefore, were regarded as conferring upon the company a beneficial interest in Christopher’s land. Thus the Lagardes’ actions could be analagised to the misappropriation of trust property.48

The interest/expectancy test has some attractive characteristics. Prominent amongst them is the association of corporate opportunities with corporate property. Assuming one agrees with the conclusion that a property right exists and has been infringed, an ‘infringement of property’ test can provide a relatively non-controversial and, hence, attractive justification for judicial intervention. Absent authorisation, a corporate fiduciary may not personally exploit an opportunity that belongs to the company: it is misappropriation to do so. The simplicity of this conclusion is a strength of the interest/expectancy test. Nevertheless, the simplicity of the conclusion may encourage some to overlook the fact that the recognition of a property interest is the product of an earlier policy decision. The point is that while the protection of property rights is an established judicial concern, the recognition of a property interest is the product of an earlier policy decision. For example, in Lagarde the court simply accepted two earlier policy decisions as to situations where an equitable interest in land can arise. In short, an option to buy land and, at least in some circumstances, a lessee’s expectation that a lease will be renewed, can confer an equitable interest in that land. Unfortunately the impact of

42 ibid 201.
43 ibid.
45 This is consistent with English law pursuant to which an option to purchase is regarded as conferring an equitable interest. See London and South Western Ry Co v Gomm (1882) 20 Ch D 562, 581 CA; Bevin v Smith [1994] 3 NZLR 648, 665 CA.
46 n 4 above.
47 Lagarde, n 21 above, 201.
48 ibid 201.
these policy considerations is hidden by the now-accepted orthodoxy of the first
decision, and the ability to justify the second decision as an extension of the
application of the rule in *Keech v Sandford*. Thus, underlying the apparently
'neutral' interest/expectancy test (neutral in the sense that this test purports to be
simply protecting pre-existing property rights), is the question 'why did the courts
recognize a property interest here?' Despite its importance, this question is easily
overlooked when property rights are claimed. So, while the simplicity of the
interest/expectancy test is a strength of the test, that same simplicity is also a
weakness. As an aside, rightly or wrongly, the draft Companies Bill continues
to use the language of property when referring to a company's opportunity. It does
this without giving guidance as to exactly when the opportunity is considered to be
the company's. The missing step is left to the courts.

**A new dimension to a director's loyalty**

Returning to *Guth* and the line-of-business test, that test was a significant advance
because it recognized that the director's role was evolving and that this had
implications for the loyalty required of directors (and senior employees in a fiduciary
relationship with the company), especially in defining corporate opportunities.
The director's new role was to identify and acquire business opportunities for the
company. This generated a new concern for corporate fiduciary law: it had to
prevent unauthorised personal exploitation of opportunities that the fiduciary
should have referred to the company. The result was to impose upon directors,
and some senior employees, an obligation to advise the company of certain
opportunities and, unless authorised to do so, not to acquire them personally.

This development mirrored the changing nature of the company, in particular
the separation of ownership from control highlighted in the 1930's by Berle and
Means. However, there are different varieties of companies. Indeed, the typical
image of a company is the owner-operator company, exemplified by the one-
person or family-run corner convenience store or engineering plant. Ignoring any
nominal shareholders and corporate officials who are there to satisfy statutory
requirements, such companies revolve around a small group of individuals. The
distinguishing characteristic of these companies is that the same group both owns
and operates the business. In the owner-operated company, the owner-operators are entrepreneurs upon
whom the ultimate success of the company depends. In such companies, the
corporate form is a device to distance the company legally from its members so
as to achieve a number of perceived advantages resulting from the company's
distinct corporate personality. Not only do the owner-operators run these
companies in their own self-interest, but 'the philosophy surrounding the

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49 n 4 above.
50 The Draft Companies Bill provides that '[a] director or former director of a company must not
use for his own or anyone else's benefit any property or information of the company, or any
opportunity of the company which he became aware of in the performance of his functions as
director, unless . . .' see White Paper-Draft Clauses, n 9 above, Sched 2, para 6.
51 A. A. Berle and G. C. Means, *The Modern Corporation and Private Property* (New Brunswick,
1932)).
52 *Salomon v Salomon* [1897] AC 22.
institution of private property assumes that they will do so. In this context, questions of corporate opportunity do not really arise, at least between the owners and the operators (ie managers), for they are one and the same: the owners manage] and the managers ow[n].

Numerically, these owner-operated companies may be the most common, but in economic significance they are dwarfed by public companies. The latter are characterised by a large number of shareholders, each usually owing an insignificant percentage of the total available shareholding. As Berle and Means recognised, the association between ownership and management is missing in these companies. Collectively, shareholders still assert ultimate control (for instance through their ability to vote for new directors), but individually they are usually unable to play any active role in determining the company's direction. The shareholders are investors, and their concern is with the company's bottom line. Control of the company is left to other individuals who owe their position to ability rather than to any shareholding.

This has consequences for the corporate opportunity doctrine: the separation of ownership from control means that most shareholders are passive investors, depending upon directors and other senior executives to advance their interests; this includes identifying and then acquiring for the company those opportunities that are suitable for its exploitation.

Through the line-of-business test, Guth refocussed the corporate opportunity doctrine from protecting unauthorised exploitation of opportunities in which a company had some pre-existing interest, to imposing an obligation upon certain company fiduciaries to surrender opportunities to the company. Should the fiduciary fail to surrender the opportunity, the courts would respond by declaring the opportunity to be the company's and imposing a constructive trust over the opportunity in favour of the company. The result was to enlarge the operation of the corporate opportunity doctrine. Guth's recognition and response to this new dimensionlargely accounts for the subsequent prominence of the line-of-business test.

**Imposition of limits to the expanded corporate opportunity doctrine**

This expanded corporate opportunity doctrine was accompanied by an appreciation that the new, wider, obligation needed limits that recognised the fact that companies are typically expansionist. As the court in Guth observed, 'to deny this [process of expansion] would be to deny the history of industrial development.'

Indeed, except where a company is subject to the operation of legal constraints

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53 Berle and Means, n 51 above, 113.
54 It could be of relevance for other parties, for instance creditors, when the diversion of an opportunity could constitute a 'fraud' on them.
57 n 51 above.
58 Cheffins, n 56 above, 13.
59 *ibid* 14.
60 Guth, n 18 above, 514.
such as the *ultra vires* doctrine, it is generally free to pursue any and every opportunity. As a result, unless the law assumes practical limits to the scope of the company's business activities, each and every opportunity that a director or senior employee becomes aware of might potentially come within the expanded notion of corporate opportunity.

Four questions were therefore identified by the court in Guth as particularly relevant in determining whether a corporate fiduciary should not pursue an opportunity for personal benefit. These questions are now treated as relevant in determining whether the opportunity is a corporate opportunity. Collectively referred to by some as the 'Guth Rule', they are firstly whether the opportunity is, from its nature, in the company's line of business and is of practical advantage to it; secondly whether the opportunity is one in which the company has an interest or a reasonable expectancy; thirdly whether the opportunity brings the self-interest of the officer or director into conflict with that of their company if the officer or director embraces the opportunity; and finally whether the opportunity is one that the company is financially able to undertake?

The first and last questions provide some of the now-necessary limits to the operation of the expanded corporate opportunity doctrine. Although our concern is with the last question, it is worth noting that in practice the requirement that the opportunity be within the company's line of business provides the most important limitation.

Despite Guth's express recognition of an impossibility argument, it is not enough for a director to claim that it was financially impossible for the company to exploit the opportunity. As the Delaware Supreme Court confirmed in Broz v Cellular Information Sys Inc, the 'Guth Rules' are 'guidelines' only: '[n]o one [question] ... is dispositive,' and 'all questions must be taken into account insofar as they are applicable.' The Broz court also went on to emphasise the factual orientation of the line-of-business test, observing that 'cases involving a claim of usurpation of a corporate opportunity range over a multitude of factual settings. Hard and fast rules are not easily crafted to deal with such an array of complex situations. Thus, rather than being a decisive consideration, the thrust of the impossibility question is merely that if a company is financially unable to acquire or develop the opportunity, the court should look more favourably on the director being able to do so.

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61 Pursuant to the *ultra vires* doctrine companies had no legal authority to enter into transactions outside the scope of their objects. Nowadays a company is able to pursue any lawful opportunity. US law recognized this earlier than English law. US companies have the capacity to engage in any lawful business unless a more limited purpose is stated in the articles or certificate of incorporation. Nevertheless and as a general rule, limitations on corporate capacity have no effect on third parties. See H. Hovenkamp, 'The Classical Company in American Legal Thought' (1988) 76 Geo LJ 1593, 1663–1664 (providing an overview of US challenge to *ultra vires*). The Model Business Company Act, ss. 301 and 304; and Del Code Ann tit 8, ss. 124 and s. 102(a)(3) (2000) are representative of the US position.

In the UK, the relaxation of the *ultra vires* doctrine is a more recent development with progressive relaxations by the Companies Act 1985 (UK) and the Companies Act 1989 (UK). While British companies must still state objects, s. 3A of the Companies Act 1985 defines the object of a 'general commercial company' as carrying on any trade or business whatsoever. Section 3A was inserted by the Companies Act 1989. Section 35 of the Companies Act 1985 (as substituted by the Companies Act 1989) further restricts the ability of the company and third parties to invoke the *ultra vires* doctrine. See generally Davies, n 3 above, 202–213.

62 Guth, n 18 above, 511.
63 Rapistan Corp v Michaels 511 NW2d 918, 922 (Mich Ct App 1998).
64 673 A2d 148, 154–155 (Del 1996).
65 ibid.
In *Guth*, since Loft itself provided the resources to develop the Pepsi opportunity, the impossibility question was irrelevant and, not surprisingly, the court gave no meaningful guidance as to what constitutes a financial impossibility. The orthodox approach in Delaware now, however, is to take a strict view. The criterion used is whether the company is actually insolvent. If the company simply lacks the funds to finance the development of the opportunity, courts can be persuaded that the opportunity may be 'sufficiently unique and valuable enough' in itself to enable the necessary finance to be raised. Thus, even in Delaware, financial impossibility arguments are hard to prove.

**Extension to other impossibilities**

Impossibility arguments are not limited to financial inability. Presumably encouraged by *Guth*, US courts have been confronted with various arguments to the effect that something that might otherwise be a corporate opportunity is not one because the company is unable to pursue it. The reasons include third party refusal to deal with the company in developing the opportunity; client dissatisfaction with the company; and legal prohibitions.

**The Guth Corollary**

In the interests of completeness, it should be noted that the court in *Guth* identified a further group of questions as relevant to determining whether a corporate fiduciary's acquisition or development of an opportunity constituted disloyalty to the company. These questions are sometimes referred to as the 'Guth Corollary.' They overlap in part with the Guth Rule, and ask firstly whether the opportunity came to the officers or directors in their individual capacity, in contrast to their official capacity; secondly whether the opportunity is essential to the company; thirdly whether the company has any interest or expectancy in the opportunity and finally whether the officer or director has wrongfully used the company's resources in acquiring or developing the opportunity?

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66 Stephanis v Yiannatis No 1508, 1993 Del Ch LEXIS 228, *12. Noted in Yiannatis v Sterianou 653 A2d 275, 278 (Del 1994). There are indications that some courts may be willing to extend their definition of financial inability to include 'temporary' insolvency and 'practical' insolvency, see Yiannatis ibid 279, n 2. See also Broz n 64 above, 155.

67 Schreiber v Bryan 396 A2d 512, 520 (Del 1978). Some courts infer that the company was financially able to pursue an opportunity from the fact that the company's pursuit of the opportunity would have benefitted it and served its interests. See Joyce v Cuccia No 14953, 1997 Del Ch LEXIS 71.


69 See Energy Resources Corp Inc v Porter 438 NE2d 391 (Mass Ct App 1982). This argument was unsuccessful and is discussed in the text to n 92–93 below.

70 See Cain v Cain 334 NE2d 650 (Mass Ct App 1975). There a director having the responsibility of promoting the corporation's business, rather than passing on a major client's dissatisfaction with the service it was receiving, established a competing transport business and acquired the client's business. The court rejected the argument that that the client's dissatisfaction meant that the opportunity was not the company's.

71 See Demoulas v Demoulas Super Markets, Inc 677 NE2d 159 (Mass 1997). This argument was unsuccessful and it is discussed in the text to n 94 below.

72 Guth, n 18 above, 510–511.

73 Rapistan, n 63 above, 922.
The existence of the Guth Corollary further reiterates the earlier point that impossibility is merely one of many considerations that are relevant in determining the status of a potential corporate opportunity.

Other US responses

Despite all of this, these impossibility arguments remain controversial in the US. The main reason is fear that 'the inevitable result [will be] to permit the diversion' of the opportunity to the corporate fiduciary.\(^\text{74}\) This is because it is 'too difficult to verify'\(^\text{75}\) the alleged impossibility 'on the basis of a set of facts largely within the control of the director.'\(^\text{76}\) The same concern has been noted in England, for example by Lord Wright in *Regal (Hastings).*\(^\text{77}\) The problem is identified in different ways, either it is 'too easy for the executive to induce the unwillingness [ie the impossibility]'\(^\text{78}\), or it is too easy for the 'fiduciary's self-interest [to] cloud his judgment'\(^\text{79}\) and 'act as a disincentive to ... solve corporate financing and other problems.'\(^\text{80}\)

The underlying concern is the problem of allowing corporate fiduciaries (or other defendants) to be judges in their own cause. Indeed, it has been argued that an underlying weakness with all impossibility arguments is that, 'if it made economic or business sense to do so, a corporation probably could eliminate [the problem].'\(^\text{81}\)

Adopting this approach, there is a considerable body of US case law rejecting financial inability, and other impossibility arguments, as being decisive considerations. Some courts have done so outright.\(^\text{82}\) Others have limited the application of such arguments by insisting that there first be appropriate disclosure of the impossibility and, following the disclosure, that the director has received the appropriate consent to their exploitation of the opportunity. Typically, this consent must be provided by the independent directors.

Although it predates *Guth, Irving Trust Co v Deutsch*\(^\text{83}\) is a prominent example of the rejection of impossibility arguments. The Sonora Products Company of America ('Sonora') had accepted an unconditional offer to buy stock in another company and thereby acquire certain patent rights considered necessary for its business. Deutsch, Sonora's President, was given the task of raising the necessary funds to finance the purchase. Ultimately he advised that he was unable to do so, and then, in conjunction with others, he personally purchased the stock. Deutsch's argument that Sonora's financial inability excused his personal purchase was successful before the trial court, but was rejected by the Court of Appeals.

Viewed against the trial court's finding of fact that Sonora was financially unable to raise the funds, the Court of Appeals' rejection of Deutsch's argument

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\(^{74}\) V. Brudney and R. Clark, 'A New Look at Corporate Opportunities' (1981) 94 Harv L Rev 998, 1021.

\(^{75}\) *Energy Resources,* n 69 above, 394. See also *Northeast Harbor Golf Club, Inc v Harris* 661 A2d 1146, 1149 (Me 1995).

\(^{76}\) Brudney and Clark, n 74 above, 1021.

\(^{77}\) n 2 above, 154.

\(^{78}\) *Northeast Harbour,* n 76 above, 1149.

\(^{79}\) *Demoulas,* n 71 above, 181.

\(^{80}\) *Northeast Harbour,* n 76 above, 1149. See also *Irving Trust* 73 F2d 121, 124 (CA 2nd Cir 1934).

\(^{81}\) Chew, n 20 above, 470–471.

\(^{82}\) See, for example, *Foley v D'Agostino* 248 NYS2d 121 (NY App 1964).

\(^{83}\) n 80 above.
has been seen by some as a rejection of the relevance of the company’s financial ability in determining the nature of an opportunity. Indeed, it has even been suggested that this case establishes a 'rigid rule' that precludes a fiduciary from pursuing an opportunity that has been rejected by the company.

This rigid view of Irving Trust might be doubted, however, and there may be less in the assertion that Guth and its line-of-business test takes a considerably 'more relaxed view' of the impossibility argument. The interesting but commonly overlooked feature of Irving Trust is that, although the Court of Appeals accepted the trial court’s finding that Sonora lacked the funds to purchase the stock, it expressed its unease about the finding. Deutsch personally owed Sonora some $125,000, but no effort was made to collect this money. The court commented that this:

tends to show the wisdom of a rigid rule forbidding directors of a solvent company to take over for their own profit a corporate contract on the plea of the company’s financial inability to perform. If the directors are uncertain whether the company can make the necessary outlays, they need not embark upon the venture [i.e., enter into the contract]; if they do, they may not substitute themselves for the company any place along the line and divert possible benefits into their own pockets.

The end result is that although some courts have used Irving Trust to deny the relevance of impossibility arguments, other more recent cases from the same Massachusetts jurisdiction reveal a shift to recognizing the potential relevance of impossibility arguments but imposing preconditions, such as disclosure, on their success: see, for example, Energy Resources Corp Inc v Porter and Demoulas v Demoulas Super Markets, Inc.

Energy Resources involved the activities of the company’s vice-president and chief scientist, Porter. Porter was an expert in the staged fluidised bed combustion of coal. On behalf of the company, Porter prepared an application with another organization for a grant to develop this process. The involvement of the co-applicant was important, if not crucial, to the application’s success. Whilst preparing the application, Porter was encouraged by the co-applicant to join with it in presenting their own competing joint application. He did this, and they were awarded the grant. Porter unsuccessfully argued that since co-applicant refused to deal with the Energy Resources Corp Inc, the opportunity was not its opportunity. The court observed:

For the reason that the firmness of a refusal to deal cannot be adequately tested by the corporate executive alone, it has not been favored as a defense unless the refusal has first been disclosed to the company. Without full disclosure it is too difficult to verify the unwillingness to deal and too easy for the executive to induce the unwillingness.

84 Durfee, n 21 above, 530.
85 Klinicki v Landgren 695 P2d 906, 912 (Or 1985).
86 ibid 913.
87 Irving Trust, n 80 above, 124.
88 ibid 124.
89 Durfee, n 21 above, 530 (a Massachusetts case).
90 n 69 above.
91 n 71 above.
92 This is a process by which coal is mixed with limestone and then burned with the consequence that the resulting sulfur is captured as a solid, rather than escaping escape into the atmosphere as a gas: Energy Resources, n 69 above, 392.
93 ibid 394.
The *Demoulas* case involved a family supermarket business, Demoulas Super Markets Inc ('DMS'), founded by two brothers, George and Telemachus. By 1970, DMS owned a chain of fourteen supermarkets. When George died suddenly in 1972, Telemachus assumed control. In the ensuing years, Telemachus established a number of new companies with members of his immediate family as the stockholders. Some of these new companies acquired new supermarkets.

The court held that the new supermarkets were corporate assets, and that DMS had not consented to Telemachus's exploitation of them. In so doing it rejected the argument that it was impossible for DMS to comply with New Hampshire liquor laws restricting the number of liquor licenses any one supermarket chain could have:

We disagree with this argument, which would limit a fiduciary's duty of disclosure to those enterprises judged by the fiduciary to be within the company's legal, financial, or institutional capabilities. Establishing such a threshold test for defining a corporate opportunity would contradict the principle ... that a fiduciary who is interested in pursuing an opportunity should not make the decision as to whether the venture is also of interest to the company. Instead, to ensure fairness to the company, opportunities must be presented to the company without regard to possible impediments, and material facts must be fully disclosed, so that the company may consider whether and how to address these obstacles ... Without such a rule, the fiduciary's self-interest may cloud his judgment or tempt him to overlook his duties.  

**Guidance for English law**

All this attention to US material should not disguise the fact that there are significant differences between US law and English law, so care must be taken when using US material in guiding reforms to English law. One important difference, heralded in the earlier extract from *Demoulas*, is that US law has developed a different conception of fiduciary loyalty demanded of corporate fiduciaries. This is the duty of fairness or fair dealing. Originally developed to evaluate self-dealing transactions, this duty has spread to influence the corporate opportunity doctrine by introducing two incidental aspects into the line-of-business test (and other corporate opportunity tests). These are a judicial willingness to review a transaction's fairness; and the acceptance of a role for disinterested directors in determining whether a director can personally exploit an opportunity. The second aspect may be a product of the first, ie the availability of judicial review, but its distinct influence is apparent. Associated with both is an obvious emphasis on disclosure.

The scope and implications of this overarching duty of fairness or fair-dealing cannot be appreciated without briefly considering their impact in self-dealing transactions. Applied to such transactions, the duty provides that the transaction is not voidable if: firstly it is fair to the corporation; or secondly it has been authorised or ratified by disinterested directors; or thirdly it has been authorised or ratified by a majority of disinterested shareholders.  

94 *Demoulas*, n 71 above, 181.
95 In Delaware there is uncertainty both over the requirements for effective shareholder authorization/ratification and its consequences. See M. A. Jacobson, 'Interested Director Transactions and the (Equivocal) Effects of Shareholder Ratification' (1996) 21 Del J Corp L 981.
not make an otherwise fair contract voidable, but it may constitute a breach of a distinct duty of disclosure, with the result that the fiduciary is required to account for the resulting profits. Even if the transaction is voidable, the corporation can elect to affirm it and seek an accounting of profits.96

As one might anticipate with concepts as loose as fairness or fair dealing, US courts have had trouble defining just what constitutes a fair self-dealing transaction. A conventional starting point in determining what fairness entails is the Supreme Court’s opinion in Pepper v Litton.97 Considerations mentioned by the court include ‘good faith,’ ‘inherent fairness,’ and ‘arm’s length bargain.’98 But, as commentators have dryly noted, each of these considerations ‘is difficult to apply,’99 and their inter-relationship is unclear. Not surprisingly, ‘judicial development of the “fairness” concept has little uniformity.’100 Insofar as it is possible to summarize the Delaware approach, the key idea is the equation of fairness with ‘conduct by a theoretical, wholly independent board of directors acting upon the matter before them.’101 The court’s concern appears to be twofold, evaluating both the substantive fairness of the transaction and the procedure by which the decision to enter into that transaction was made.

Of particular significance in understanding the US approach is an appreciation of the unresolved tensions in its application. The scope of the duty may, it seems, be modified by disinterested director approval so as to lessen the degree of subsequent judicial scrutiny. Disclosure is important to shareholder and disinterested director approval, but there are also indications that US courts see disclosure as a necessary requirement of the duty of fairness, thereby making disclosure a distinct duty. This approach is having its own discernable impact on the scope of the corporate opportunity doctrine.

**The growing US emphasis on disclosure**

Initial support for the recognition of an independent duty of disclosure is provided by a trio of Delaware decisions in which the Supreme Court used broad language to extend the disclosure obligations of directors when dealing with shareholders.102 These cases are *Lynch v Vickers Energy Corp*,103 *Weinberger v UOP, Inc,*104 and *Smith v Van Gorkom.*105

*Lynch* involved the corporate fiduciary’s purchase of the corporation’s stock from a stockholder. The court described a duty of ‘complete candor,’ of ‘complete frankness … [under which c]ompleteness, not adequacy, is both the norm and the

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96 *Hayes Oyster Co, State ex rel v Keypoint Oyster Co* 391 P2d 979, 986 (Wash 1964).
98 ibid 306. Formulations subsequently developed include ‘intrinsic fairness’ (*Marciano v Nakash* 535 A2d 400, 403–404 (Del 1987)) and ‘entire fairness’ (*Geddes v Anaconda Copper Mining Co* 254 US 590 (1920); *Weinberger v UOP, Inc* 457 A2d 701, 711 (Del 1983)).
100 ibid.
101 *Weinberger*, n 98 above, 709 n 7. See also *Johnston v Greene* 121 A2d 919, 925 (Del 1956); *Oberly v Kirby* 592 A.2d 445, 467 (Del 1989) (‘[t]he key to upholding an interested transaction is the approval of some neutral decision-making body’).
102 These cases are discussed by L. A. Hamermesh, ‘Calling Off the Lynch Mob: The Corporate Director’s Fiduciary Disclosure Duty’ (1996) 49 Vand L Rev 1087, 1117.
103 383 A 2d 278 (Del 1977).
104 n 98 above.
105 488 A 2d 858 (Del 1985).
mandate 106 to hold that the fiduciary was required to disclose to the stockholder his knowledge of corporate information which suggested that the price paid by the fiduciary was unfairly low.

'[T]he obvious duty of candor required by Lynch' was used in Weinberger to support the rule that 'one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy.' 107 There the nominee directors appointed by the majority stockholder did not disclose the existence or results of a feasibility study that they had prepared for the majority stockholder in preparation for a proposed buy-out by the majority shareholder.

Smith concerned the degree of care the directors had taken in giving advice to the stockholders on a merger proposal. The court held that the directors had breached their fiduciary duties to be adequately informed before giving such advice and in 'fail[ing] to disclose all material information such as a reasonable stockholder would consider important' 108 in voting on the merger proposal.

Further support for the recognition of an independent duty of disclosure is provided by the New Jersey case of Cameco, Inc v Gedcke. 109 Gedcke was a middle manager in Cameco, responsible for arranging the transportation of its food products to retail stores. This required Gedcke to co-ordinate shipping schedules, negotiate shipping rates and supervise those employees involved in the loading process. Unbeknown to Cameco, Gedcke and his wife formed a corporation whose business was arranging the transportation of food products. Two of its clients were Cameco's competitors. The substantive issue was whether this service to competitors constituted disloyalty to Cameco, but the court's attention focused on a procedural point. Moreover, a complete lack of factual findings by the trial court also precluded 'a definitive analysis' of the substantive issue. 110 Nevertheless, the court emphasized the importance of disclosure to this substantive issue, suggesting that 'employees generally should inform employers of their plans before establishing an independent business that might conflict with that of the employer,' so as to 'alert the employer to potential problems' and to 'protec[t] the employee from a charge of disloyalty.' 111

The influence of disclosure on the corporate opportunity doctrine

The impact on the corporate opportunity doctrine of this growing emphasis on disclosure is evident in Demoulas. Recall that there the court stressed the need to disclose opportunities:

'[T]o ensure fairness to the company, opportunities must be presented to the company without regard to possible impediments, and material facts must be fully disclosed, so that the company may consider whether and how to address these obstacles ... Without such a rule, the fiduciary's self-interest may cloud his judgment or tempt him to overlook his duties.' 112

106 Lynch, n 103 above, 281.
107 Weinberger, n 98 above, 711.
108 Smith, n 105 above, 893.
110 ibid 788.
111 ibid.
112 Demoulas, n 71 above, 181.
Further, the court suggested that the corporate opportunity doctrine 'may be considered to be a rule of disclosure.'113 The influence of mandatory disclosure is also apparent in other tests, for example that suggested by the American Law Institute ('ALI'). Indeed, ALI has been seen as recommending a 'bright-line' approach pursuant to which 'disclosure is determinative.'114 Its proposed code provides that:

a ... senior executive may not take advantage of a corporate opportunity [which includes, 'any opportunity to engage in a business activity of which a senior executive becomes aware and knows is closely related to a business in which the corporation is engaged or expects to be engaged'] unless: (1) the ... senior executive first offers that corporate opportunity to the corporation and makes disclosure concerning the conflict of interest ... and the corporate opportunity ... 115

Against this background it is not surprising that, even in Delaware, there is some support for disclosure of the opportunity and then the company's rejection of it as prerequisites to the success of an impossibility argument.116

Additionally, there are practical considerations in the US emphasis on disclosure. This is the need for certainty. In Guth, the court tried to provide certainty by enumerating the factors comprising the Guth Rule and the Guth Corollary. However, as the court observed in Broz:

The teaching of Guth and its progeny is that the director or officer must analyze the situation ex ante to determine whether the opportunity is one rightfully belonging to the corporation. If the director or officer believes, based on one of the factors articulated above [ie, the questions identified in the Guth Rule and the Guth Corollary], that the corporation is not entitled to the opportunity, then he may take it for himself.117

Of course, the corporate fiduciary's assessment is not decisive. The court in Broz noted that 'an error in the fiduciary's assessment of the situation will create future liability for breach of fiduciary duty.'118

Some corporate fiduciaries are unwilling to assume the risk that their assessment of the opportunity's status is wrong, yet they still wish to pursue the opportunity personally. The solution has been to extend the application of the safe-harbour applied in self-dealing transactions. The corporate fiduciary can inform the board of the opportunity and seek its authorization to pursue it. If disinterested directors give this authorization, the 'spectrum of a post hoc judicial determination' that the corporate fiduciary 'has improperly usurped a corporate opportunity is removed.'119

Irrespective of whether disclosure is seen as an independent duty or a prudent step, the growing US emphasis on disclosure is undermining the significance of any recognition they give to impossibility arguments. As a result, there may be no significant difference in practical terms between the UK Steering Group's

113 ibid 180.
114 See Ostrowski v Avery, 703 A2d 117, 125–126 (Conn 1997); Northeast Harbor, n 76 above, 1151–1152.
115 Corporate Governance, n 21 above, § 5.05(a).
116 Fliegler v Lawrence 361 A2d 218, 219 (Del 1976). See also Cellular Information Sys, Inc v Broz 663 A2d 1180, 1186 (Del Ch 1995) but cf Broz, n 64 above, 157.
117 Broz, n 64 above, 157.
118 ibid.
119 ibid. See also A Teixeira & Co, Inc v Teixeira, 699 A2d 1383, 1388 (RI, 1997) (recognizing the safe-harbour concept).
recommendation and the position US law appears to be moving towards. Respectively, these are rejecting impossibility arguments but allowing independent directors to authorise another’s personal exploitation of the opportunity (the Steering Group’s recommendation); and recognising impossibility arguments, but requiring disclosure and confirmation by independent directors of that impossibility and, either directly or by implication, authorisation of the director’s personal exploitation of the opportunity (the position US law appear to be moving to).

Should English law recognise impossibility arguments?

Returning to English law and the debate on impossibility arguments, many will argue that there is an inherent attractiveness, if not logic, in the impossibility arguments. This is displayed in the question: ‘How can an opportunity be a company’s if the company is unable to exploit it?’

This attractiveness or logic may explain in part Guth’s acceptance that financial impossibility is one of a number of relevant considerations. However, this recognition raises practical concerns that have resulted in the development of discrete controls on the test, including narrow conceptions of impossibility, ie requirements of actual insolvency and the imposition of disclosure and authorisation requirements, the effect of which is to restrict the availability of impossibility arguments.

There is, however, a more significant objection to impossibility arguments than these practical concerns. The recognition of the impossibility argument per se is inconsistent with the modern expectation that the director’s role, especially the executive director’s role, is to ‘promote the success of the company.’ Guth recognised one aspect of this: that the director’s task was to identify business opportunities for the company’s exploitation. But, as recognised in some of the US material rejecting impossibility arguments, there is another aspect to this: the director must also identify impediments confronting the company (eg financial problems), and then either develop strategies to overcome them or evaluate the strategies proposed by others.

Unconditional acceptance of the availability of impossibility arguments raises real prospects of conflicts of interest. A director who is able to raise impossibility arguments may face the ‘temptation to refrain from exerting [their] strongest efforts on behalf of the company since, if [the company] does not meet the obligations, an opportunity of profit will be open to [the fiduciary] personally.’

Regal (Hastings) demonstrates that English courts appreciate the conflict between impossibility arguments and the director’s role in overcoming difficulties confronting the company in pursuing an opportunity. There, the company had been actively pursuing the acquisition of a lease of certain cinemas before

120 To use the language of the draft Companies Bill, White Paper-Draft Clauses, n 9 above, Sched 2, para 2.
121 Discussed in the text to n 74–n 81 above.
122 See Note, ‘Corporate Opportunity’ (1961) 74 Harv L Rev 765, 773 (‘Every major executive … would seem obligated to make a genuine effort to enable the company to secure the additional profit’).
123 Irving Trust, n 80 above, 124.
124 n 2 above.
125 It is present in the ‘trust’ opportunity case of Keech v Sandford, n 4 above.
encountering the landlord's requirements, which apparently precluded its acquisition of the leases. Their Lordships did not suggest that the defendant fiduciaries would be successful in their attempts to find ways for the company to satisfy the landlord's requirements, and thereby enable the company to acquire the opportunity, but nevertheless they would not permit the directors to raise these difficulties to justify their personal acquisition of the opportunity.

Another example is Industrial Development Consultants Ltd v Cooley.\(^{126}\) Cooley was 'an architect of considerable distinction and attainment'\(^{127}\) in the gas industry. In conjunction with other companies, the plaintiff company provided a comprehensive construction service, largely in the private sector. Wishing to expand into the public sector and gas industry, the plaintiff successfully invited Cooley to become its managing director. Later Cooley was approached personally with an offer to become the project manager for certain projects in the gas industry. Cooley did not advise the company of this opportunity, but resigned to pursue it. In his defence, Cooley argued, and the court accepted, that the party offering the contract would have been unlikely to have employed the plaintiff company.\(^{128}\) Nevertheless, the court rejected this impossibility argument on the ground that it was Cooley's job as the managing director 'to try and persuade [the other party] to change their minds.'\(^ {129}\) The court's recognition of the inconsistency between the impossibility argument and Cooley's role is captured in the following fuller extract of its grounds for rejection:

> It cannot be said that it is anything like certain that the plaintiff would ever have got this contract. ... On the other hand, there was always the possibility of the plaintiffs persuading the [party offering the contract] ... to change their minds; and, ironically enough, it would have been the defendant's duty to try and persuade them to change their minds. It is a curious position under which he whose duty it would have been to seek to persuade them to change their minds should not say that the plaintiffs suffered no loss because he would never have succeeded in persuading them to change their minds.\(^ {130}\)

As Lawrence Collins J subsequently observed in CMS Dolphin Ltd v Simonet,\(^ {131}\) 'what he [Cooley] did was to divert to himself the very type of contract it was his job to secure for the company (even though it was very unlikely that the company would have won the contract).'

**Conclusion**

The line-of-business test (and, as part of that test, the US recognition of the impossibility argument) arose from an appreciation that company directors have a role in advancing their company's interests. This test expanded the concept of corporate opportunity from an opportunity in which the company had an interest, or a recognised expectancy of acquiring, to an opportunity that the company could exploit profitably. For some companies, however, any potential opportunity could fall within this wide test.\(^ {132}\) In order to provide some necessary limits to the

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\(^{126}\) [1972] 2 All ER 162.
\(^{127}\) ibid 166.
\(^{128}\) ibid 176.
\(^{129}\) ibid.
\(^{130}\) ibid.
\(^{131}\) [2001] 2 BCLC 704 at [90].
\(^{132}\) Brudney and Clark, n 74 above, 1004.
line-of-business test, courts added additional constraints, such as requiring the company to be financially or otherwise able to acquire or exploit the opportunity.

Even though the director's practical role was, indirectly, a reason for recognising impossibility arguments, it is also a reason for viewing those arguments with suspicion. Directors must evaluate the impediments (or impossibilities) that appear to prevent their company from pursuing attractive opportunities, and must then either develop strategies to overcome the impediments or consider strategies proposed by others. So, despite the US recognition of impossibility arguments, it is not surprising that modern US practice is to make such arguments difficult to prove and to curtail their impact through the development of satellite rules. The emphasis on disclosure, especially, has ensured that a director who wishes to pursue an opportunity cannot simply conclude, privately, that it is impossible for the company to pursue it.

The end result is that, in practice, there may be no significant difference between the UK Steering Group's recommendations and the position US law now appears to be moving towards. Despite this, there are certain advantages in the Steering Group's formulation of the rules. As a matter of principle, the rejection of impossibility arguments is more consistent with a director's role and its requirement to avoid conflicts of interest. A director's ability to exploit an opportunity personally should not depend upon some private evaluation of whether or not the opportunity is capable of exploitation by the company. Any necessary flexibility is better provided by allowing the board of directors to specifically authorise the exploitation.

The UK Steering Group's implicit recommendation that the status of a corporate opportunity should not depend upon whether the opportunity is capable of exploitation by the company should be followed. The Government's White Paper does this.