Waiver of the Corporate Opportunity Doctrine

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Even as the worst of the credit crisis seems to have passed, credit availability remains tight. During the summer, even after the peak of the crisis, the extra yield investors demanded to own investment-grade corporate debt rather than treasuries remained almost triple the average for the decade ending in 2007. Private investment is the most obvious alternative: in 2008, public companies raised $123 billion through private investments, 86% more than in 2007. At the same time, the crisis has made securing private investment more important than ever, as major private investment can send positive signals to the market about a company, leading to easier credit on better terms in the near future. Thus, to the extent that credit availability remains tight, public companies need to do all they can to facilitate private equity investors who might be willing to satisfy crucial demand for capital. One step that they should consider is waiving the corporate opportunity doctrine and related fiduciary duties as they would apply to such private equity investors.

The corporate opportunity doctrine precludes officers and directors from personally benefiting from opportunities that belong to the corporation. As classically stated in Guth v. Loft and further developed in Broz v. Cellular Information Systems, the corporate opportunity doctrine holds that "a corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation." By contrast, "a director or officer may take the corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual capacity and not in his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity." The analysis is fact-intensive, and the burden is on the defendant to show that he did not usurp a corporate opportunity. This makes it an easy claim for a derivative claimant to threaten and a difficult one for a director to defend, particularly at the summary disposition stage. And this could easily dissuade private equity investors whose board seats will come with fiduciary duties: if they will need to worry that all their subsequent private investments in other possibly related firms will be attacked as usurped opportunities of the first company they bought into, they will justifiably think twice before committing their capital; hence the need for waiver of the doctrine.

The Delaware Chancery Court cast doubt on the ability of corporations to waive the corporate opportunity doctrine in Siegman v. Tri-Star Pictures, Inc. Tri-Star Pictures, Inc. had amended its charter to waive the corporate opportunity doctrine and certain fiduciary duties for certain large shareholders and individuals who served on the Tri-Star board. The Tri-Star court held that the charter amendments violated the Delaware General Corporation Law ("DGCL") because Section 102(b)(7) of the
DGCL said that although a corporation may eliminate personal liability of directors for a breach of fiduciary duty, a corporation may not eliminate the liability of a director for a breach of his duty of loyalty. Since the corporate opportunity doctrine is an outgrowth of the duty of loyalty, the *Tri-Star* court held that the charter could be construed as a violation of Section 102(b)(7) and this finding alone warranted the denial of the defendant’s motion to dismiss.

In response to the doubt created by *Tri-Star*, in 2000 the Delaware General Assembly amended the DGCL to give Delaware corporations the power to "[r]enounce, 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." The legislative history of the amendment emphasizes that it was "intended to eliminate the uncertainty regarding the power of a corporation to renounce corporate opportunities in advance raised in *Siegman v. Tri-Star Pictures, Inc.*" The legislative history underscores that "[i]t permits the corporation to determine in advance whether a specified business opportunity or class or category of business opportunities is a corporate opportunity of the corporation rather than to address such opportunities as they arise." The General Assembly thus created an opportunity to make private equity financing more available to companies.

Although some may argue that the waiver is unnecessary to raise private equity capital, practical considerations encourage a private equity investor to insist upon this waiver as a closing condition for its capital contribution. Some have argued that such waivers are unnecessary because the private equity investor can avoid post-hoc judicial determinations of whether the director usurped a corporate opportunity by presenting the opportunity to the board. But even that option provides only limited protection while seriously complicating the business operation of a large private equity firm, and so the private equity investor should demand more protection prior to making a capital commitment. There are at least four reasons why this is so.

First, once a deep-pocketed private equity investor announces to the world through a large public investment that it is interested in a certain space, the private investor will likely be approached with additional investment opportunities. It is unreasonable to expect the private investor to present every opportunity to the board, and it will be difficult to determine which of these offers originate from the firm’s capacity as an investor, and which relate to its position as a part of the business in which it invested.

Second, it is unclear whether the private equity investor should present the opportunity to the board when he is first approached with the opportunity (before he even knows whether it is worth pursuing) or right before final documentation is to be signed. The former could force the private equity investor to constantly ask the board to consider whether an opportunity is a corporate opportunity, and the latter would allow the board to derail an investment after the private equity investor and the counterparty have already invested substantial resources into the potential transaction.
Third, the speed of deal-making, one of the attributes which makes certain private equity investors such attractive sources of capital, does not lend itself to constant review by a board of directors potentially uninvolved in the transaction.

Fourth, although the relevant judicial inquiry asks whether the opportunity is one that belongs to the corporation at the time the opportunity is presented to the director, the decision of whether to sue will almost certainly have to be made after a substantial period of time has lapsed. Suppose a company in the music industry needed capital five years ago. In exchange for a substantial investment by a private equity investor, the music company gave the private equity investor a board seat. Suppose a year or two after this investment, Apple needed capital and approached this same private equity investor for capital, and he in fact made an investment in Apple. Years ago, an investment in Apple was not in the music company's line of business. Today, that determination may well be incorrect. It is unclear when it changed, but the private equity investor should not bear the risk of being subject to litigation if, years after an investment was made, it turns out profitable, and it could be argued that the investment was in the line of business of another company on whose board he was a member. Companies constantly re-invent themselves, exit unprofitable lines of business and enter new areas. The *post-hoc* nature of the decision to initiate litigation may be the most important reason why the private equity investor should seek the waiver of the corporate opportunity doctrine as a closing condition for a substantial investment in a public company.

Private equity investors with capital to deploy control a valuable but scarce resource in today’s capital markets. Companies should be willing to waive the corporate opportunity doctrine in this context to attract that capital.

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5. Id. at 155.
6. Id.
7. Guth, 5 A.2d at 512.
13. Id.
15. Id. at 159.