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Corporations - Officers and Directors - Acquistion of Corporate Opportunity After Rejection by Board of Directors

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CORPORATIONS—OFFICERS AND DIRECTORS—ACQUISITION OF CORPORATE OPPORTUNITY AFTER REJECTION BY BOARD OF DIRECTORS—Defendant Odlum, president and director of Airfleets, Inc., was privately offered the opportunity to buy patents for a self-locking nut and the stock of the company which held an exclusive license to manufacture it. The board of directors, when offered the opportunity by Odlum, approved purchase of the stock but rejected the patent rights. Odlum then purchased these rights for himself and a minority stockholder brought a derivative suit for an accounting. *Held,* a director is absolutely disqualified from purchasing a corporate opportunity for himself, even after the opportunity has been rejected by a disinterested majority of the board of directors. Any other rule would necessitate an attack upon and judicial evaluation of the subjective business judgment of the board. *Greene v. Allen,* (Del. Ch. 1955) 114 A. (2d) 916.

The principal case marks a significant departure from the general rule that rejection of a corporate opportunity[1] by a disinterested majority of the

[1] The reasons given for the finding of a corporate opportunity in Airfleets, a company organized to finance the sale and lease of airplanes [see MOODY, BANK AND FINANCE

board of directors gives an officer or director the privilege of taking advantage of the opportunity.[2] One lone case, *Irving Trust Co. v. Deutsch*,[3] was cited as authority for the somewhat remarkable position of the instant case. That case held that a plea of corporate inability to perform a contract admittedly essential to the corporation's existence does not justify the directors' action in taking over the contract for themselves.[4] But even if such a ruling was justified, the rationale of the case was the encouragement of fiduciaries to exert their best efforts to help raise the necessary funds by closing off any possible alternative and more profitable avenue. The breach of duty found by the court was the action of the directors in placing themselves in a position where their self-interest would tend to limit their efforts in helping the corporation to carry out its commitments. That the directors involved were in a position where the dual nature of their interests prejudiced the corporation is borne out by the court's observations on the facts justifying the rule.[5] The rule in the principal case, however, is based not on the dual position of the interested director but on the difficulty in ascertaining the basis of judgment of the disinterested majority of the board in dismissing a potential opportunity as undesirable —in effect carrying the conclusive presumption of self-interest attached to the interested director over to the whole board.[6] Even if the *Irving Trust*

MANUAL 903 (1951)], would suggest that the interest of the corporation and the duty of the defendant extend to an extremely wide range of investment opportunities. See, generally, Fuller, "Restrictions Imposed by the Directorship Status on the Personal Business Activities of Directors," 26 WASH. UNIV. L. Q. 189 (1941); 13 TEMPLE L. Q. 534 (1939).

After the ruling of disqualification, the court in the principal case proceeded to find an alternative ground of liability based on a finding that Odlum had dominated the board and had not sustained the burden of proving its good faith. While this weakens the authority of the case on the per se disqualification rule, it also tends to perpetuate the rule by limiting the probability of further appeal.

[2] Cowell v. McMillin, (9th Cir. 1910) 177 F. 25; Turner v. American Metal Co., 268 App. Div. 239, 50 N.Y.S. (2d) 800 (1944), app. dismissed 295 N.Y. 822, 66 N.E. (2d) 591 (1946); McKee v. Brazzle, 99 Okla. 36, 225 P. 520 (1924); American Circular Loom Co. v. Wilson, 198 Mass. 182, 84 N.E. 133 (1908); Sandy River R. v. Stubbs, 77 Me. 594, 2 A. 9 (1885); RESTITUTION RESTATEMENT §191 (1937); 3 FLETCHER, CYC. CORP., perm ed., §862.1 (1947); 39 COL. L. REV. 219 (1939); 31 CALIF. L. REV. 188 (1943).

[3] (2d Cir. 1934) 73 F. (2d) 121, cert. den. 294 U.S. 708, 55 S.Ct. 405 (1934).

[4] Authority for the rule was Wing v. Dillingham, (5th Cir. 1917) 239 F. 54, which held director transactions voidable per se on facts which the court admitted were too oppressive to allow the contract to be enforceable in equity, even in the absence of a fiduciary duty. It should be noted that the court in the Irving Trust case cited the facts there, not the case rule, which is believed to be almost obsolescent today. See notes 9 and 10 infra. For the suggestion that the real basis of the decision in the Irving Trust case was the unfairness of the transaction, see 35 COL. L. REV. 289 (1935).

[5] The principal defendant had been empowered by the board to secure the needed funds. The defendant was indebted to the corporation in an amount in excess of that needed to carry out the contract and made no efforts to obtain the needed money after the board accepted the contract.

[6] If the court in the Irving Trust case had believed their rule to be so far-reaching, there would have been no need for it to dispose of an inter-director settlement also at issue in the case on the basis of failure by the interested director to make full disclosure to the board. Cf. Perrine v. Pennroad Corp., 29 Del. Ch. 531, 47 A. (2d) 479

case is good precedent for finding a breach of duty by Odlum, that case was brought by a trustee in bankruptcy and does not provide authority for a suit by a minority stockholder. Most authority leaves discretion to bring such a suit with the corporate board unless fraud, ultra vires acts, or oppression are alleged and proved.[7] Since the number of cases treating these problems in the corporate opportunity context are limited, it is helpful to examine the authority in a more active area, that concerned with transactions between a director and his corporation.[8] Almost all jurisdictions hold that where the transaction is approved by an independent majority of the board, it is binding on the corporation, at least "where the transaction is not unfair to the corporation and the directors have acted in good faith."[9] New Jersey still holds such transactions voidable by a majority of the stockholders,[10] but even it does not allow a minority holder to set aside the fiduciary's contract unless it is ultra vires, fraudulent, or oppressive.[11]

The holding in the principal case is a severe restriction on a director's investment opportunities.[12] It gives minority stockholders a new sanction for "strike suits" to harass the corporation. One share of stock can form the basis for preventing related but unwanted ventures from being acquired by a trusted fiduciary.[13] Should a stockholder succeed in obtaining a constructive trust, the corporation would be forced to purchase oppor-

(1946); Sterling v. Mayflower Hotel Corp., (Del. 1952) 93 A. (2d) 107; Gottlieb v. Heyden Chemical Co., (Del. 1952) 90 A. (2d) 660.

[7] Karasik v. Pacific Eastern Corp., 21 Del. Ch. 81, 180 A. 604 (1935). See Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455, 23 S.Ct. 157 (1903); 13 FLETCHER, CYC. CORP., perm ed., §5822 (1947).

[8] To the extent that a director's contract and the rejection required as a defense to taking a corporate opportunity both concern the direct dealing of an "interested" fiduciary with his fellow members of the board, they may be said to involve essentially the same problem—the difficulty in detecting whether the directors were influenced by the desires of the interested fiduciary. The analysis is made more meaningful by the fact that the court in the Irving Trust case treated the question there as one of inter-director dealing.

[9] See 3 FLETCHER, CYC. CORP., perm ed., §931 (1947); 24 A.L.R. (2d) 60 at 71 (1952). See also the cases cited in note 6 supra. While there are substantial variations found in the cases collected under these authorities as to the party who may sue, burden of proof, and presumption of good faith, the grouping is at least adequate to indicate that the jurisdictions noted do not allow voidability per se by the corporation.

[10] Rothenberg v. Franklin Washington Trust Co., 127 N.J. Eq. 406, 13 A. (2d) 667 (1940). 3 FLETCHER, CYC. CORP., perm. ed., §930 (1947) and 24 A.L.R. (2d) 60 at 99 (1952) list a number of cases in which the language suggests that several states other than New Jersey still follow the minority rule of voidability per se. When these cases are analyzed in conjunction with the authority cited in note 9 supra, only Maryland, New York, Iowa, and New Hampshire remain without authority for the majority rule. But see Indurated Concrete Corp. v. Abbott, 195 Md. 496, 74 A. (2d) 17 (1950); Blaustein v. Pan-American Petroleum & Transport Co., 293 N.Y. 281, 56 N.E. (2d) 705 (1944); Kurtz v. Oxborrow, 232 Iowa 174, 4 N.W. (2d) 857 (1942); Mica Products Co. v. Heath, 81 N.H. 470, 128 A. 805 (1925).

[11] Helfman v. American Light & Traction Co., 121 N.J. Eq. 1, 187 A. 540 (1936).

[12] Cf. Lange Soap v. Ward, (Tex. Civ. App. 1925) 269 S.W. 851.

[13] See McKee v. Brazzle, note 2 supra.

tunities which the directors may have rejected on the basis of sound business judgment. Acceptance of the rule removes the right or necessity of judicial examination of the real nature or good faith of such transactions. Such an examination, utilizing the tools of analysis and practical discretion successfully employed in other areas of the law, is, surely, a preferable alternative to the inflexible rule of the principal case.

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