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Firm Opportunities: Property Right Assignments, Firm Detriment, and the Agent's Performance Obligation

Ronald J. Coffey*

I. THE CONSTRAINED FACT SET AND ITS IMPLICATIONS: MODE OF DETRIMENT, COMPASS OF THE PERFORMANCE OBLIGATION, AND CONFLICT OF INTEREST

The problem of developing and implementing¹ an explanatory theory of property right assignments and liability rules² regarding firm opportunities³ is posed in starkly challenging analytical form by the constrained

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¹ Part IV., *infra*, discusses the relation between the "state of theory" and problems of implementing theory in the form of rules assigning property rights and stating conditions of liability.

² I assume the existence of, and a rationale for, a legal performance obligation that is an emanation of either case law (as in Delaware) or statute (as under Model Business Corporation Act § 8.30). The performance obligation is applicable, with perhaps some adaptations, to all types of firm agents, and its strictures most clearly encompass agent decisions regarding (1) the use and disposition of firm assets, and (2) the terms and the acquisition and disposition, on behalf of the firm, of firm securities. The analytical framework presented here supports an inquiry into the circumstances under which such performance obligation can (or should) be extended to agent decisionmaking regarding the acquisition of return generating projects *from* and *for* persons *other than* his firm. To reach that question, it is necessary to (1) specify reasons for recognizing firm property rights in the future return streams of projects to which the firm has not yet formally (that is, by means of the traditional elements of claim origination or transfer) acquired a claim (*see infra* part III.B.), and (2) establish a chain of effects leading from the acts of the agent to some (at least potential) encroachment on such property rights (*see infra* part III.A.). Encroachments (or detriments) may be of different and subtle modes or types. Moreover, because of rule implementation problems (*see infra* part IV.), potential detriment (of one or more such types), together with the competing interest that attends an agent's decision regarding an opportunity (*see infra* note 6), may be sufficient to justify nondamage forms of relief, without further inquiry into the dimensions of detriment, or to shift, against the agent, one or more of the dynamics (standard of proof, burden of persuasion, and the required rigor of justificative analysis) involved in a judicial probe of the existence and extent of detriment.

³ While this paper deals primarily with the extent to which the performance obligation of directors and officers of a corporation is, or should be, analyzed to restrict their ability to pursue return generating projects for and with persons other than their firm, the same themes can be found in the case or statutory law of simple or complex noncorporate agent-principal relationships involving individuals or nonnatural persons. The inquiry arises with respect to any firm, by which I mean a combination of factors dedicated to production which is the source of implicit contracting (and perhaps the object of law-supplied institutional arrangements) among factors (particularly between service and capital furnishers), in which there are one or more holders of claims to the residual, fluctuating returns generated by the firm's production projects, and in which there are one or more delegates who have assented to make discretionary choices among alternatives on behalf of the residual claimholders. The core analysis presented herein pervades all firms, in any form, and so the

example⁴ where an agent⁵ of a firm (including a director or an officer of a

title of this piece refers to "firm" opportunities, instead of to the more limited subset of "corporate" opportunities.

⁴ By sifting out detail, one assembles factual prototypes from which are developed policy theories that favor or disfavor, in noticeably varying degrees (against a background of goal selections, assumptions about reality, and impediments to judicial implementation of theory), assignments of property rights and specifications of the conditions of liability.

It is a fundamental principle indeed that knowledge is always gained by the orderly loss of information, that is, by condensing and abstracting and indexing the great buzzing confusion of information that comes from the world around us into a form which we can appreciate and comprehend.

K. BOULDING, *ECONOMICS AS A SCIENCE* 2 (1970).

⁵ The legal conception of "agent," defined in uselessly conclusory terms as one who owes a fiduciary duty to his principal, has been enriched by the financial and managerial economics literature on the dynamics of delegation, that is, the reasons for, and putative content of, implied arrangements, enunciated in fine as the legal (default or unvariable) rules of fiduciary duty between principal and agent.

The nature and causes of fiduciary duty emerge as a function of natural barriers to the formation of comprehensive, express (market) contracts that are explicitly stated in terms of price, quantity, quality, and time as to each and every marginal unit of service rendered by an operative acting on behalf of another. The resultant performance obligation owed by operatives (or delegates) is, instead, a manifestation of implicit contracting, which, if expressed, would not be highly specified as to price, quality, quantity, and time, but would rather take the generalized form: "I (agent) undertake to make decisions that I consciously believe to be exclusively in pursuit of [a particular] objective or set of objectives, after exerting [a particular] objective level of effort and exhibiting [a particular] objective level of quality (or competence) in preparing for, analyzing, and justifying my choices." Such an implied undertaking is recognized, enunciated, and enforced by the law, either as the default arrangement (that is, the understanding that obtains absent express modification) or as an immutable arrangement between the parties.

The circumstance that triggers the inference of the implied undertaking is the vesting of discretion in an operative to make choices among alternatives for the benefit of the investor. The content of the arrangement arises from barriers to complete and explicit orthodox (market) arrangements, two such barriers being uncertainty and opportunism (or moral hazard)—which is to say, the threat that the operative will "fail" (that is, not exhibit competence because of lack of endowment) and the danger that the operative will either "shirk" (that is, not exert efforts) or "divert" (that is, funnel off property) in pursuit of his own objectives. See generally O.E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 15-84, 298-324, 385-408 (1985); see also Baumol, Book Review, 17 *RAND J. ECON.* 279 (1986).

Some suggest, as a purely descriptive matter, that economic principal-agent theory deals with matters at least partially different from the legal notions that underlie an agent's fiduciary duty. See, e.g., Kornhauser, *An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents*, 70 *CALIF. L. REV.* 1345, 1346 (1982). Others suggest, prescriptively, that the differences between the two bodies of insight, especially regarding operatives serving as directors and officers of corporations, ought to be preserved. See, e.g., Clark, *Agency Costs Versus Fiduciary Duties*, in J. PRATT & R. ZECKHAUSER, *PRINCIPALS & AGENTS: THE STRUCTURE OF BUSINESS* 55 (1985). I suggest that economic analyses probing the origin, nature, and content of second-best arrangements between persons whom economists call agents and principals are extremely useful in providing an explanatory theory for what has been traditionally referred to as the fiduciary duty ensconced in judicially-created or statutory rules. The domains and ranges of discretionary choice-making among alternatives may differ from one sort of agent to another—a janitor is not, as directors and executive officers are, engaged to make choices, with broad discretion and freedom from review, regarding such large matters as operating projects, capital structure, or payout, but even he is faced with making choices regarding the handling of information contained in important papers that he might find lying around. Nonetheless, discretionary power to choose among alternatives (within highly

corporate firm) decides to acquire, for the account of persons other than his firm (commonly, but not necessarily, for his own account⁶), a return generating project⁷ (or some aspect thereof⁸) and where he implements his decision by transacting with persons other than his firm. Firm oppor-

variegated boundaries, to be sure) is the common thread underlying the performance obligation of all types of persons whom the law calls agents and of some whom it does not but should. Directors and officers are indeed agents, vis-à-vis holders of claims to distributions from the firm, in this basic and richly revealing sense.

⁶ An agent serving more than one principal may, in connection with a firm opportunity, favor one principal over another. An agent may also direct an opportunity to the natural objects of his bounty or to persons to whom he is indebted or from whom reciprocity is expected. In all of these cases, the agent achieves some good for himself, even though he will not directly or indirectly be invested in the opportunity. See generally *Johnston v. Greene*, 35 Del. Ch. 479, 121 A.2d 919 (1956) (a (rather questionable and naive) discussion of a hypothetical diversion of an alleged corporate opportunity to only one of multiple firms for which defendant served as officer and director and of an actual diversion to friends). Hence, such cases are, economically, the agent's pursuit of the opportunity, even though his own account (that is, some species of ownership acquired by him through traditional mechanics of transfer) is not formally implicated.

⁷ Return generating projects often relate to the asset side of the firm. These include, of course, investments in the securities of other firms. See *Wall St. J.*, Sept. 8, 1986, at 21, col. 3 (describing *Litton Industries'* suit against its financial adviser for allegedly making its tender offer for *Itek Corp.*'s stock more expensive by pre-offer purchasing in the trading market).

Return generating projects are not, however, confined to those of potential effect on the asset side of the firm. Opportunities may take the form of any means of potentially increasing the marketable value or affecting other characteristics of the firm or its securities, particularly common shares. Such effects can be achieved through decisions regarding the securities (in the broad sense of claims to distributions) issued by the firm. For example, a repurchase of outstanding securities can affect the marketable wealth of shareholders. See T. COPELAND & J. F. WESTON, *FINANCIAL THEORY AND CORPORATE POLICY* 498-500, 520-24 (1983). So, too, can a primary sale of new securities. In such cases, it is at least conceivable that an agent's decisions, with and on behalf of persons other than the firm, might interfere with the financial activities of the firm. But see *FMC Corp. v. Boesky*, 673 F.Supp. 242 (N.D. Ill. 1987) (court could not conjecture how agent's aiding another to purchase his firm's outstanding shares could have disrupted, in a manner that would give the firm standing to seek relief under SEC rule 10b-5, attempts of firm to repurchase shares pursuant to an offer that was differentiated in terms with respect to management and nonmanagement shareholders but was offered pro rata within such segments, even where the agent's behavior caused increased firm borrowing to fund the repurchase and changed the relative terms of the management and nonmanagement offers). *FMC Corp.* later appealed, and on July 21, 1988, the Court of Appeals for the Seventh Circuit reversed. See *FMC Corp. v. Boesky*, No. 87-1678 (7th Cir. July 21, 1988) (LEXIS, Genfed library, Courts file). Much earlier, the Delaware Chancery Court had suggested that, by trading for his own account with third parties in his firm's outstanding securities, an agent could, at least with sufficient potential to justify nondamage relief, detrimentally affect a repurchase by the firm of its securities. See *Brophy v. Cities Serv. Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949). *Unocal Corp.* seems to be asserting, against *Goldman, Sachs & Co.*, a claim similar to that urged by *FMC* against its financial adviser in *Boesky*. See *Wall St. J.*, April 15, 1987, at 5, col. 1.

At this juncture, I suggest simply that a financial maneuver by a firm may be viewed as a return generating project. This observation should prompt further inquiry into (1) whether it can be theoretically or empirically demonstrated that, by dealing for and with persons other than his firm, an agent can, at least sometimes, curtail the benefits of the firm's exploitation of a financial decision, and (2) what circumstances will furnish satisfactory proof of such curtailment.

⁸ Just as opportunities are not limited to return generating projects on the asset side of the firm, so they need not take the form of an entire project, but may relate to facets of a project, such as availability of factors of production or access to customers. See *infra* part III.

tunity issues are sometimes raised and treated in cases where there are additional or substitute circumstances, such as the agent's making decisions for his firm,⁹ using facts belonging to his firm's internal store of confidential information,¹⁰ or implementing his decisions by transacting with his firm.¹¹ But these variants enable alternative and (possibly) easier analyses.¹² By ruling out such elaborations, a more difficult version of the problem is stated.

In the constrained setting, an agent's pursuit of an opportunity can produce changes in a firm's marketable value (either originating on the asset side of the firm and derivatively affecting the wealth of firm securityholders or originating within the firm's financial structure) or changes in a firm's characteristics of other-than-marketable (that is, unsys-

⁹ See, e.g., *Comedy Cottage, Inc. v. Berk*, 145 Ill. App. 3d 355, 495 N.E.2d 1006 (1986) (officer took actions on behalf of the firm which led to firm's loss of its lease, which officer then seized for himself). I refer here to decisions for the firm other than a decision as to whether to reject firm pursuit of an opportunity. Agents in the upper echelons of decisionmaking discretion and finality (such as directors and officers) will frequently make or participate in the decision to reject (or not) an opportunity that has been offered to the firm on a first refusal basis. And, even when such a first refusal offer is not extended (which is to say, where the agent pursues an opportunity to satisfy his own ends, without first offering it to his firm), his decision can be viewed as an implicit rejection of the opportunity on behalf of his firm. And so, the decision to reject (on behalf of the firm) is one in which the agent is often involved. See *infra* parts II. & III. But rejection is not the kind of decision that is relevant to the analytically prior issues of assignment of property rights and identification of firm detriment. Other types of associated decisions, such as that involved in *Comedy Cottage*, are.

¹⁰ Of this ilk are cases where an agent, in order to generate returns to himself or persons other than his firm, uses his firm's nonpublic technological information, information about furnishers of factors of production, or information about customers. See, e.g., *Taylor v. Terry*, 279 Ark. 97, 649 S.W.2d 392 (1983) (officer becomes aware of firm's note coming due; buys in for his own account at foreclosure); *BBF, Inc. v. Germanium Power Devices Corp.*, 13 Mass. App. Ct. 166, 430 N.E.2d 1221 (1982) (managers used information that had become part of the firm's internal store of facts). Use of nonpublic firm information can also be viewed as making a decision (as to how to handle the information) on behalf of the firm. See *supra* note 9.

¹¹ When, for example, an agent (say, a director or an officer of a corporation) purchases a line of business (or the entire business, for that matter) from his firm, his decision can be viewed as the pursuit of what could be labeled a corporate opportunity. Similarly, the decision on behalf of the firm to sell could be viewed as a rejection of the opportunity on behalf of the firm.

¹² It is a contention of this paper that it is necessary to establish substantial grounds for granting a property right in a return generating project (or some aspect thereof) before it can be called a firm opportunity. It is also suggested that the bases for assigning property rights include: transactional succession through the traditional elements of transfer, claim of ownership, possession, relative competence to exploit, and expenditure of resources (including creativity) toward origination and exploitation. See *infra* part III. B. The variants described in the text accompanying notes 9-11, as contrasted with the constrained pattern limned earlier in the text, exhibit in relatively greater measure the foregoing grounds for assigning, to the firm (or to its investors, or some class thereof), property rights in return generating projects that might be affected by agent decisionmaking. Moreover, when an agent makes transactional decisions on behalf of, or transacts with, his firm, changes in the value or other characteristics of the firm or its outstanding securities occur more directly and immediately than they do in the constrained fact set. See *infra* text accompanying notes 16-19.

The variants are also susceptible of solutions that are not explicitly, at least, based on a firm opportunity analysis.

tematic) value significance¹³ (again, either originating on the asset side of the firm and derivatively affecting such characteristics of the firm's securities or originating within the firm's financial structure). But, in the constrained scenario, such shifts and changes do not occur pursuant to the same functional relationships that apply to distinguishable classes of agent decisionmaking. Imminent threats to firm value occur, for example, where agents cause their firm to dispose of assets that are, in a fairly well-defined sense, already the property of the firm,¹⁴ or where they make decisions that change the contract terms of, or cause the firm to dispose of or acquire, claims to distributions from the firm (that is, the firm's securities). In connection with these latter decisions, the firm is in a position where, if involved persons other than the firm gain value,¹⁵ the firm (or some sector of its securityholders) will lose value as a matter of necessary logical inference.¹⁶ In a disposition of firm assets, for example, the firm is necessarily exposed to the possibility not only of surrendering a portion of the total gains from exchange¹⁷ that may inhere in the transac-

¹³ See *infra* note 15 for an explanation of the meaning of marketable (systematic) and nonmarketable (unsystematic) value. Among the matters that can have other than marketable value significance are: (1) the opportunity to match one's tolerance (or preference) for risk with the risk associated with a firm's stream of future returns (though such risk, separately, has marketable value significance as one of the variables in the process of project valuation); (2) the opportunity for an individual to capture returns to his human capital that can be generated (and therefore realized) only by his rendering services in connection with a particular asset project; and (3) the opportunity for an individual to derive consumptive satisfactions from being associated with a particular asset project. Part V. covers the manner in which the nonmarketable value significance of opportunities might fit into a theory of firm opportunities otherwise dominated by marketable or systematic value concerns.

¹⁴ By "well-defined" I mean supported by an ample presence of the bases (proposed in note 12) for assigning property rights.

¹⁵ "Value" can be used to mean the price that a good can fetch in the market as a function of the bidding and asking of all market participants and after deducting transaction costs. This sort of value will be referred to as "marketable" or "systematic" value. It is to be contrasted with the excess over marketable (systematic) value that a particular economic agent might, because of his peculiar tastes or endowments, be willing to pay for the satisfactions (that is, contributions to well being) flowing from his holding a good. See, e.g., D. McCLOSKEY, *THE APPLIED THEORY OF PRICE* 196-97 (2d ed. 1985). See *supra* note 13. I call this second type of value "nonmarketable" or "unsystematic" value, because it cannot be realized in the market system but must be captured by holding the good and receiving its stream of internal returns (or contributions to well being). The deprivation of unsystematic value is referred to as an unsystematic cost. Though much of the analysis herein centers on marketable or systematic value—just as other areas of legal analysis do—still, there are instances where unsystematic values and costs become significant, especially where the putative goals of principal and agent, inferred from the salient features of their relationship in light of assumptions about why economic actors would normally adopt such features, demonstrate a substantial tending of their arrangement toward recognition of nonmarketable values. See *infra* part V. A similar approach appears in contract law, where damages, which are primarily a function of marketable or systematic values, are the exclusive remedy, except where there is special evidence that unsystematic values were considered significant by the parties to the undertaking, in which case specific performance, a form of relief designed to protect such values, becomes available.

¹⁶ This proposition holds as long as no synergy from the transaction is assumed, and where gain is limited to capturing a greater portion of the total gain from exchange or to receiving a wealth transfer.

¹⁷ In any exchange process, there is a range of prices at which the transactors would consider

tion, but also of suffering outright wealth transfers.¹⁸ This is not to say that either of those two results will always occur; only that, to the extent that one side of the bargain increases its share of the gains from trade or receives a wealth transfer, the other side necessarily forfeits.

In contrast, when a director or an officer (or other firm agent, including nondirectors and nonofficers) deals with third parties in business opportunities for his own account or the account of persons other than his firm, his snaring the full gains from exchange or somehow capturing a wealth transfer in that transaction does not imply, by a process of unconditional inference, a correlative detriment to his firm or its investors. Something else, in lieu of a necessarily reciprocal transactional structure, must be shown to demonstrate the conditions of linkage between an agent's pursuit of an opportunity and detriment to his firm in terms of diminution of total firm value, redistribution of wealth among firm investors,¹⁹ or the imposition of unsystematic costs.²⁰

The lack of a necessarily reciprocal relationship between the effects on the agent and effects on his firm is also a mark of certain nonopportunity patterns, such as an agent's purchasing or selling his firm's outstanding securities in secondary transactions. When he trades without disclosure of nonpublic material information relating to his firm's securities,²¹ an agent's gains are not necessarily accompanied by reciprocal

themselves better off by having struck a deal. That range is the total gain from exchange, but it goes in varying proportions to each side of the transaction depending on who bargains better, when bargaining is possible. See, e.g., D. McCLOSKEY, *THE APPLIED THEORY OF PRICE* 89-96 (1985).

¹⁸ A wealth transfer would befall the seller when a price is struck below the price that is established by bidders and offerors in the market—which is to say, when no particular set of transactors are price setters. In an exchange setting that admits of bargaining by both sides or price setting by the seller, the seller suffers a wealth transfer when price is struck below the seller's range of better-offness possibilities or below the price that the seller could have set, respectively.

¹⁹ Even if firm value does not diminish, redistribution of wealth among classes of investors can occur if unexpected asset-project or financial-structure changes are made. For example, *ceteris paribus*, if the total risk of the asset project of a firm is raised in a manner unanticipated by debtholders at the time they invested, wealth can be shifted from debtholders to shareholders. See T. COPELAND & J. F. WESTON, *supra* note 7, at 414-15. This possibility could be significant in the opportunity context for a firm with debt, if a return generating asset project became available from a third party and if the total risk of such project were greater than that of the firm's current asset project. Substituting asset projects could (if unanticipated by the debtholders) raise the marketable (systematic) value of the firm's share, to the detriment of the firm's debtholders, even if it is assumed that the two switched projects have the same marketable value and that therefore firm value could not be increased by the substitution.

The foregoing is an example of the subtle ways in which values to segments of a firm's investors can be increased and, as important, how interception of return generating projects by an agent, acting for himself or others besides his firm, can waylay such value additions, in which there may be a basis for giving such investors a property right. Alertness to these possibilities, which have been dramatically exposed and explicated by the financial economics literature based on the so-called Option Pricing Model of Black and Scholes (see, e.g., Galai & Masulis, *The Option Pricing Model and the Risk Factor of Stock*, 3 J. FIN. ECON. 53 (1976)), is a prerequisite to an analysis of potential firm detriment.

²⁰ See *supra* notes 13 & 15 for a description of unsystematic costs.

²¹ Consider also a sale of a control block of outstanding securities or a sale of a noncontrol

losses to the firm or, through changes in the firm's capital structure, to all or some segments of the firm's investors. Instead, the locus of first instance detriment (if any) must be viewed as the particular investors who trade with the agent (and who are locked in a reciprocal gain-loss relationship with the agent), and, if the firm is to be implicated at all, other pathways of detriment to the firm, besides the inequalities in the agent's bargain with the trading securityholders, must be identified.²² But even in this kindred context of an agent's transacting for and with persons other than his firm in his firm's outstanding securities, it is somewhat easier to identify and trace the pathways (or circuits) of detriment to the firm or classes of its securityholders, for the subject matter of the agent's transaction, namely, the firm's securities, furnishes the means by which the wealth of securityholders can be affected by influencing either firm decisionmaking or the value-determinant characteristics of the market for the firm's securities.²³

Besides the special problem of identifying the paths of detriment to the firm or its investors, two other peculiar analytical twists must be confronted when an agent acts for and with persons other than his firm. The first involves placing the agent's decision within the ambit of (not in the sense of being a violation of, but simply in the sense of being subject to scrutiny under) his performance obligation. When an agent makes decisions for his firm, performance-obligation coverage is independently clear by virtue of the firm's being the person on whose behalf the agent purportedly acts (that is, the person whose purpose is an avowedly major motivation of the agent), and the inquiry moves to the separable questions whether conflict of interest was present and whether the decision conformed to standards of conduct contained in the performance obligation.

Detecting conflict of interest in the agent's decision is the second task that takes a special turn in the constrained opportunity fact set. While conflict of interest is not a *sine qua non* to finding a breach of the performance obligation, its presence can cause shifts in one or more of the dynamics of judicial inquiry (namely, burden of persuasion, standard of proof, and the degree of theoretical and factual rigor with which the agent's decision must be defended) specified by courts as protocols for examining evidence to determine whether the standards of the performance obligation were met.²⁴ Conflict of interest also makes available nondamage forms of relief, such as the constructive trust and accounting

block together with an agreement for board replacement—two very traditional problem areas involving transactions with and for persons other than the firm.

²² See, e.g., *In re ORFA Sec. Litig.*, 654 F.Supp. 1449 (D.N.J. Feb. 2, 1987).

²³ The same can be said about the allied question whether the sale of control, which involves a transaction in outstanding securities, can be accompanied by detriment to the firm or securityholders.

²⁴ See generally PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 15-57 (Tent. Draft No. 5, 1986).

remedies frequently sought in opportunity cases.²⁵ When an agent acts both for and with the firm, conflict is easiest to perceive. When, as in the constrained opportunity setting, the agent acts neither for nor with the firm, conflict is more difficult to detect.

In the opportunity pattern, unlike other classes of controversies involving questions of an agent's adherence to the standards of conduct embraced within his performance obligation, neither the question whether the agent's decision was covered by such standards of conduct nor the question whether conflict of interest existed is separable from the question whether (and how) detriment to the firm or securityholders ensued. That is so because there are no independent ways of establishing answers to those questions. Not until detriment is successfully demonstrated in theory and fact can the other two questions be answered, and they are answered simultaneously, by necessary inference, with the conclusion as to detriment.

As shown in parts II. and III. particularly, the inquiry into whether a return generating project is a firm opportunity or not is simply a way of asking how detriment to the firm or securityholders could and did occur, given the sobering insight that many opportunities will be value-neutral even though they bear the indicia used by courts to determine whether opportunities belong to the firm. Hence, all three issues (detriment, applicability of the performance obligation, and conflict of interest) are settled at once under the rubric of finding that an opportunity is—as the matter is put in the corporate-firm context—a “corporate” opportunity.

II. TRADITIONAL HEURISTICS IN THE CORPORATE FIRM CONTEXT

This section traces the major contours of a typical judicial attempt to determine whether a return generating opportunity (for example, an asset project for sale by a third party) may be pursued for his own account (or for the account of some person other than his firm) by a director or an officer (both “agents” in the sense of having relatively broad discretion to choose among alternatives and being relatively free from ad hoc review). It is not too severe a generalization to say that, at the core of the judicial analysis (perhaps one should say dialectic), is what can be usefully decomposed into a three-pronged investigation of the conditions (or elements) of property right assignments and liability.²⁶

²⁵ See, e.g., *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 5.08(c) (Tent. Draft No. 3, 1984).

²⁶ I prescind from analyzing who bears the burden of persuasion in proving (disproving) the conditions of property right assignments, mode of detriment, and, ultimately, breach of the performance obligation. To discuss burdens would unduly complicate the analysis, although, as a tool for implementing policy through formulations of liability rules and property right assignments, placement of the burden of persuasion should not be underestimated. Burden placement—like selection of sanctions; delineation of required and permissible lines of factual inquiry (that is, the array of case-specific conditions that will be required and permitted to be proven in order to determine outcomes); specification of the theoretical and factual rigor with which the existence of relevant condi-

The first subsidiary issue is whether the person seeking to pursue an opportunity for his own account,²⁷ to the exclusion of the firm, has assumed,²⁸ and still occupies,²⁹ a position, the characteristics of which support an inference (presumably by implied assent, where none is expressly stated) that such person will make good faith and careful decisions to maximize the wealth of the firm's investors, particularly shareholders. Immediately, then, the courts look for evidence that the director or officer was subject to a performance obligation that would, in light of the scope of its duration (the period of the agent's tenure), its domain (the subject matter of the agent's assigned decisionmaking responsibility), and its range (the breadth of the agent's discretion and freedom from ad hoc review),³⁰ become implicated if the further circumstance of firm or investor detriment were also shown to exist by virtue of the agent's pursuit of a return generating project. In the absence of an express statement that such an obligation exists as a matter of private contract between an agent and a firm's investors, the courts³¹ must employ notions of implied assent (or implicit contracting), together, perhaps, with broader social welfare criteria, as the basis for it. As they go about pricking out the content of the agent's implied assent, courts must necessarily proceed on assumptions about the chief characteristics (particularly the motivations and

tions must be demonstrated; and specification of standards of pleading and standards of proof—is a function of (1) the presence and intensity of conflict of interest, and (2) the "state" of dominant explanatory theory regarding the kind of harm that may be associated with a course of conduct (stated in fairly constrained or highly generalized terms), the relative likelihood of offensive (that is, harmful) and nonoffensive outcomes, and the likely complexity of ad hoc judicial attempts to separate offensive and nonoffensive cases. Cf. *infra* part IV. But placement of burden is a secondary question as far as my paper is concerned.

²⁷ Hereafter, reference to the opportunity-taker's "own account" includes his steering the opportunities to persons other than his firm.

²⁸ See, e.g., *Whaler Motor Inn v. Parsons*, 372 Mass. 620, 363 N.E.2d 493 (1977) (promoter purchased for himself prior to becoming involved in preincorporation promotional venture).

²⁹ See, e.g., *Master Records, Inc. v. Backman*, 133 Ariz. 494, 652 P.2d 1017 (1982) (all bases for imposing performance obligation on former officer and director had lapsed before he formed a business exactly like that of his former firm). Resigning a position that was subject to a performance obligation does not, per se, lift the strictures of that obligation. See, e.g., *Wilmington Trust Co. v. Consistent Asset Management Co.*, Civ. No. 8867 (Del. Ch. March 18, 1987) (WESTLAW, DE-CS database) (recognized post-resignation obligation but refused to grant preliminary injunction because of state of proof); see also, *Southeast Consultants, Inc. v. McCrary Eng'g Corp.*, 246 Ga. 503, 273 S.E.2d 112 (1980) (applying corporate opportunity statute).

³⁰ See, e.g., *Gregg v. U.S. Indus.*, 715 F.2d 1522 (11th Cir. 1983) (Florida law; former chief executive with no present management responsibilities; the domain and range of his performance obligation as consultant would not extend to capturing opportunities discovered from sources other than the firm's internal information).

³¹ In adopting statutory statements of agents' performance obligations, such as the triple-faceted standard of conduct contained in Model Business Corporation Act § 8.30, legislatures, too, must consider the origins, nature, and content of implicit private contracting as well as broader social welfare objectives. Because, as a general rule, statutory performance obligations are worded so as to make them applicable only to directors' and officers' decisions on behalf of the firm, the directors' and officers' obligation with respect to their decisionmaking for and with persons other than the firm is generally viewed as a creature of the judiciary.

objectives) of a "model" firm investor (especially the holder of equity (that is, claims to residual, fluctuating returns from the firm)) as well as assumptions about the nature of the market in opportunities that can fulfill the principal desires of the model investor.

The second question—focusing now on the relationship between pursuit of the opportunity and effects on the firm and not directly on the status of the person trying to pursue it for his own account—is whether the opportunity is one that is "corporate." A battery of constituent tests³² is applied in the typical analytical sequence. The standard questions asked are:

(1) Had the firm, through its high-level decisionmakers, previously shown an interest in this or a similar opportunity?³³

(2) Is the opportunity akin to the firm's existing business? The tests of "kinship" may be slippery, being variously couched and lavishly nuanced, usually under the "line-of-business" taxon.³⁴

³² See, e.g., *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983) (discussing: (1) general categories of opportunities, namely, (a) those "entirely extraneous," (b) those in the "same or a direct line" of business, and (c) those complementary to the firm's business; (2) the three judicial series of tests, namely, (a) the "interest or expectancy" series, (b) the "line-of-business" series, and (c) the "fairness" series; (3) a separate set of tests referred to as the "recurring [relevant] circumstances" series; and (4) a decomposition of "functionally related" into the two subcomponents of "same or direct line" and "complementary"); *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974) (discussing the line-of-business (described as "more flexible"), interest-or-expectancy (described as "restrictive"), and fairness series of tests; combining these sets of tests; and allocating burdens of persuasion on subsets of tests in a so-called two-step judicial protocol).

³³ See, e.g., *Farber v. Servan Land Co.*, 662 F.2d 371 (5th Cir. 1981) (Florida law; frequent firm discussions of possible acquisition); *Zidell v. Zidell, Inc.*, 277 Or. 423, 560 P.2d 1091 (1977) (prior indications of interest especially important when alleged opportunity is to purchase the firm's own shares); *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983) (prior negotiations by firm identified as one of the factors recurrently considered to be relevant).

³⁴ For example: "an activity as to which . . . [the firm] has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business . . . and is consonant with its reasonable needs and aspirations for expansion. . . ." *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 279, 5 A.2d 503, 514 (1939). In other passages, the *Guth* opinion, which is considered a *fons et origo* of opportunity rubrics, uses language that is infelicitously susceptible of disparate meanings; for example: "essential" to the firm and "of practical advantage" to the firm, which seem quite different from one another and inconsistent in some respects with the language quoted earlier.

In *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974), the line-of-business inquiries were merged with other sets of tests. As regards the subtests traceable to *Guth* phraseology, *Miller* formulated "ranges" of factual conditions, for example: "the relationship of the opportunity to the corporation's business purposes and current activities—whether essential, necessary [at one extreme], or merely desirable to its needs and aspirations [at the other extreme]. . . ." *Id.* at 225, 222 N.W.2d at 81.

To the basic line-of-business group of tests, *Miller* added a question about "the competitive nature of the opportunity—whether prospectively harmful or unfair. . . ." *Id.*

See also *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983) (using line-of-business language like "entirely extraneous," "in the same or direct line," and "complementary"); *Nicholson v. Evans*, 624 P.2d 727 (Utah 1982) ("valuable and germane"); *Farber v. Servan Land Co.*, 662 F.2d 371 (5th Cir. 1981) ("valid and significant . . . [firm] purpose," "need not be of utmost importance to . . . [firm] welfare," and "fit into present [firm] activities"); *Southeast Consultants, Inc. v. McCrary*

(3) Have resources already owned by the firm been employed, at least partly, in the pursuit of the opportunity?³⁵

(4) Did the director or officer receive information about the existence of the opportunity in his role as agent for the firm?³⁶ It is unclear whether this inquiry refers to the mentality of the source of information about the opportunity—which is to say, the source's belief that such information would be conveyed to the firm—or whether the question refers to the domain of the director's or officer's job responsibilities, that is, whether one of his expressly or impliedly assigned tasks is to collect and convey such information to the firm.³⁷ Of course, it is possible that both tests are contemplated, either conjunctively or disjunctively.

(5) Is the opportunity one in which the firm has an interest or expectancy?³⁸

(6) Did the firm have the financial ability to pursue the opportunity?³⁹

(7) Was the third party from whom the opportunity was available willing to transfer it to the firm?⁴⁰

Eng'g Corp., 246 Ga. 503, 273 S.E.2d 112 (1980) ("intimately or closely associated with the existing or prospective activities of the [firm]").

³⁵ See, e.g., *Lowder v. All Star Mills*, 75 N.C. App. 233, 330 S.E.2d 649 (1985) (use of physical facilities; borrowing funds; use of employees); *Gulledge v. Frosty Land Foods Int'l*, 414 So. 2d 60 (Ala. 1982); cf. *Chelsea Indus. v. Gaffney*, 389 Mass. 1, 449 N.E.2d 320 (1983).

³⁶ See generally *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983); *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974).

³⁷ If it relates merely to the belief of the source, then information about opportunities furnished while the source is unaware of the director's or officer's status, or while the source believes that the director or officer is "off duty" (say, where the latter is on the beach during a vacation), might not meet the test.

³⁸ See, e.g., *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974) (an "opportunity in which the corporation has a 'beachhead' in the sense of a legal or equitable interest or expectancy growing out of a preexisting right or relationship"). The *Miller* court gave existing firm lease or patent rights as examples of "beachheads." *Id.* at 222, 222 N.W.2d at 80 n.11. See also *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983) (firm that provided administrative services to an operating firm could be an opportunity of the latter under interest or expectancy test; *Miller* "beachhead" subtest for "interest or expectancy" did not appear to be strictly met); *Southeast Consultants, Inc. v. McCrary Eng'g Corp.*, 246 Ga. 503, 273 S.E.2d 112 (1980) (strict *Miller* "interest or expectancy" test not met, but "beachhead" found nonetheless).

³⁹ Compare the judicial receptivity to this argument in *A.C. Petters Co. v. St. Cloud Enterprises*, 301 Minn. 261, 222 N.W.2d 83 (1974) with the judicial hostility exhibited toward it in the following cases: *Kliniki v. Lundgren*, 298 Or. 662, 695 P.2d 906 (1985); *Nicholson v. Evans*, 624 P.2d 727 (Utah 1982). Judicial suspiciousness of the financial incapacity contention has led some courts, like *Kliniki*, to require, as prerequisites to making the argument, that disclosure of the opportunity be made to the firm and that the firm be given an opportunity to find financing through disinterested efforts. Sometimes the third party will not permit such disclosure, however. See *Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957 (Del. 1980).

⁴⁰ This question, like financial incapacity, meets with varying judicial presentiments. Compare *Maritime Fish Prod. v. Christensen*, 100 A.D.2d 81, 474 N.Y.S.2d 281 (1984) (not involving a director or an officer but drawing a parallel between the performance obligations of agents of similar domains of assigned responsibility and ranges of discretion and freedom from ad hoc review; requir-

(8) Did the director or officer who diverted the opportunity from his firm have, as a function of his assigned role within the firm, a responsibility to search for or develop opportunities of the sort at issue?⁴¹

"Yes" answers to these questions cut in favor of the opportunity being deemed a corporate one. One would surmise, from the surface dialectic of most opinions, that what is at work in the typical judicial approach is a rather rough tallying of the signs and magnitudes of the answers, in the somewhat heuristic style typical of situations where a decisionmaker is facing an analytical or informational overload and resorts to rules of thumb. If the weight of the answers points in the direction of an opportunity not being a corporate one, then the director or officer is free to pursue it on his own. Otherwise, the inquiry moves to a third phase.

A corporate opportunity—one that has been deemed to be "corporate" from the preceding phase of analysis—may be availed of if it is offered to the firm and rejected by an informed and properly constituted management or shareholder group that is sufficiently free of the influence of the officer or director who seeks the opportunity for himself.⁴² Sometimes it is suggested that an agent seeking an opportunity may exculpate himself (even without a disinterested rejection having in fact occurred) by showing that a disinterested management unit (the board or appropriate delegates) would, if given the chance, have rejected the opportunity.⁴³ But such a showing, which assumes the nonexistence of the firm's informed and disinterested rejection, is nearly the equivalent of establishing that the opportunity was not a corporate one to begin with.⁴⁴ Some courts may divide the inquiry into a two-step burden-allocating sequence in which the plaintiff complaining about an agent's diversion must bear the burden of showing the sufficient presence of a certain set of factors

ing disclosure of opportunity to firm and opportunity for firm to persuade third party to deal before third party refusal to deal could be argued) *and* *Energy Resources Corp. v. Porter*, 14 Mass. App. Ct. 296, 438 N.E.2d 391 (1982) (requiring disclosure and opportunity to persuade) *with* *Peterson Welding Supply v. Cryogas Prod.*, 126 Ill. App. 3d 759, 467 N.E.2d 1068 (1984) (accepting, among other assertions, the argument that the third party would not have dealt with the firm; some evidence that firm was fully informed).

⁴¹ See, e.g., *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974) ("nature of the [agent's] . . . relationship to the management and control of the corporation").

⁴² See *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 5.05(a)(3)(B) & (C) (Tent. Draft No. 5, 1986). The ALI approach tacks on the additional requirement, presumably as a precondition to releasing the agent from the threat of a constructive trust and an accounting as well as eliminating the possibility of damages, that the disinterested decision conform to the business judgment rule (if made by directors) or not constitute waste (if made by shareholders). The tacked requirement is not normally discussed in the cases.

⁴³ See, e.g., *Johnston v. Greene*, 35 Del. Ch. 479, 121 A.2d 919 (1956). The ALI project allows the same type of defensive showing after an *interested* rejection. See *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 5.05(a)(3)(A) (Tent. Draft No. 5, 1986).

⁴⁴ This is a principal thrust of part III, *infra*. Hence, the position of this paper is at odds with that of the ALI project.

that imply potential detriment⁴⁵ to firm or securityholder values—cutting in favor of the opportunity being a corporate one and the agent's performance obligation being applicable to a necessarily conflict-of-interest decision by the agent—and the agent must bear the burden of showing a certain set of factors that negate the implication of the plaintiff's case.⁴⁶ Such a division of burdens imperfectly parallels the common practice of courts in other contexts of agent decisionmaking. Based on the theory of burden placement,⁴⁷ courts first call upon plaintiff to establish that a challenged decision was covered by the agent's performance obligation and that the decision was made under conflict-of-interest circumstances, and, second, where conflict is shown by plaintiff, courts call upon the defendant to establish the entire fairness of his decision (which is to say, that it comports with firm and shareholder value maximization goals). But, the burden bifurcation process makes the particulars of defendant's showing no less relevant to the central question of whether the opportunity is "corporate" in the first place.

Once an opportunity is found to be a corporate one, a number of conclusions follow with respect to an agent's pursuit of it, or his diversion of its pursuit to others to suit his purposes.⁴⁸ The first is that the director's or officer's performance obligation becomes applicable to his decision to pursue the opportunity for his own account, which becomes the functional equivalent of his rejecting it on behalf of his firm. Second, because concluding that an opportunity is a corporate one (that is, one belonging to the firm) is just a way of saying that firm value or the values of some class of its investors would suffer if the opportunity were pursued by the agent and not the firm, it follows by necessary inference that the agent's decision to pursue, if not independently approved or ratified, is a conflict-of-interest decision that his firm should not pursue. Such a conclusion would, in nonopportunity contexts of agent decisionmaking, call for the application of the highest level of judicial scrutiny (called the "fairness" test)⁴⁹ to answer a third question, namely, whether detriment was suffered by the firm or its securityholders. But this third question,

⁴⁵ "Detriment," as explained in part III., *infra*, requires a more-than-insubstantial likelihood that the pursuit of the opportunity by the firm will be better than simply marketable-value-neutral for the firm or some class of its investors. The complete analytical path (chain, circuit) leading to a "detriment" conclusion decomposes into subsidiary findings: (1) the agent's pursuit of the opportunity would (a) prevent the firm from preserving, to the same extent possible if the agent were not to pursue the opportunity, the spread between the breakup value and the prepursuit capitalized future return value of an existing firm project, (b) deprive the firm of capturing the capitalized future return value of a new project whose net present value is greater than zero, or (c) deprive common shareholders of an increase in the capitalized future return value of their shares (whether or not firm value is affected as in (a) or (b)), and (2) there are reasons for assigning (to the firm or to the shareholders, as the case may be) property rights in the opportunity, notwithstanding the absence of the traditional events (mechanics, elements) of property rights transfer.

⁴⁶ See *Miller v. Miller*, 301 Minn. 207, 222 N.W.2d 71 (1974).

⁴⁷ See *supra* note 26.

⁴⁸ See *supra* note 6.

⁴⁹ See *supra* text accompanying notes 24-25.

too, is answered in the affirmative by a finding that an opportunity is a corporate one. All of these conclusions are bundled up in the finding of the "firm" (or "corporate") status of an opportunity. That being so, and absent disinterested firm rejection, which is the functional equivalent of an approval of the agent's pursuit, the predicate is established for nondamage forms of relief, which typically become available when unfair conflict-of-interest agent decisionmaking is found.

If a corporate opportunity is pursued by a director or an officer without establishing the conditions of release, a corporate claim (which may be pursued either by the corporation itself or, upon fulfillment of certain conditions, by a shareholder derivatively) will lie against him for various forms of relief. As just indicated, these include nondamage forms of relief, such as an injunction against acquiring the opportunity (if suit can be commenced quickly enough) or the imposition of a constructive trust (under which the director or officer is the constructive trustee and the corporation is the beneficiary) if the opportunity has already been taken. An accounting of returns actually earned on the project may also be obtained.

III. TOWARD A CLEARER ANALYTICAL FRAMEWORK AND EXPLANATORY THEORY: CORE OBJECTIVES AND ASSUMPTIONS

A. *Categories of Greater than Marketable Value Neutrality*

1. For the Firm

In part I., I identified the principal reasons why the constrained version of the firm opportunity problem creates special analytical obstacles to the invocation of a director's or an officer's performance obligation. Unlike decisions made for or with his firm, an agent's decision to capture an opportunity to suit his own purposes is not the kind of decision where gain to the agent necessarily means, absent synergy, a loss to the firm. Gains to the agent from pursuing the opportunity are not, therefore, the focal point of the inquiry. Rather, the investigation must be sighted on the conditions under which the firm or its securityholders can suffer detriment (that is, deprivation of marketable value protection or enhancement, where a property right assignment is justified) from not pursuing a particular return generating project, whether or not the agent would gain if he were to pursue it. The fact that the agent's decision to pursue is, in the constrained fact pattern, neither for the firm (in the sense of binding the firm to another) nor with the firm (in the sense of binding the firm to the agent or the objects of his beneficence) also eliminates any separate grounds upon which to invoke the agent's performance obligation or to find conflict of interest. Hence, in order to see how the performance obligation—that is, the requirement that directors and officers honestly and reasonably believe that their decisions are aimed at marketable value maximization—can be apposite, and in order to see how a conflict of

interest can exist, it is first necessary to identify the principal theoretical sets of circumstances in which the firm (or perhaps some class of securityholders) could be worse off (assuming certain specified property right assignments⁵⁰) by the firm's not pursuing an opportunity.

Identification of the principal detriment scenarios must begin with the intellectually bracing and analytically telling observation that, since there will always be some cost entailed in the pursuit of an opportunity by a firm, it is possible that such pursuit will be value-neutral⁵¹ (or worse) for the firm; that is, the value to the firm of pursuing the opportunity may be simply equal to (or less than) its cost. Under such circumstances, the firm is indifferent to the opportunity as far as its value is concerned; that is, it could substitute any other value-neutral project for the opportunity. If pursuit (that is, purchase) by the firm would be value-neutral (or worse) for the firm, courts ought not conclude that an opportunity is one that must be offered to the firm—not, at least, if marketable value of the firm is to be the exclusive normative criterion.⁵²

A major teaching of this central insight is that a return generating project is not necessarily better than value-neutral for a firm simply because its expected dollar return or expected rate of return is superior to that generated by existing firm projects. First, in order to arrive at the marketable value of a claim on future returns, dollar returns must be discounted or capitalized by the rate of return demanded by the marketplace for projects having a risk (or uncertainty of returns) equal to that of the opportunity being valued.⁵³ Hence, a return generating project having expected dollar returns (say, as the mean of a probability distribution of projected possible future return outcomes) of twenty is not more valuable, in marketable terms, than one having expected dollar returns of ten, if, because of a difference in risk between the two projects, the discount rate applied to the former is two or more times that applied to the latter. Second, even in the realm of projects whose dollar returns have been capitalized at the market demanded rate, so that their rates of return are set at the highest available for their risk classes, the projects are value-neutral vis-à-vis one another in the eyes of acquirers—meaning that they equally justify a given dollar amount of investment—even though their promised rates of return vastly differ. There is no marketable value gain or loss in choosing one over the other, in exchanging one for the other, or

⁵⁰ Though the question of property right assignments may be analytically prior to an investigation of modes of detriment, it is, for ease of exposition, taken up next.

⁵¹ In this part, "value" means "marketable" value. Consideration of "nonmarketable" or "unsystematic" value (see *supra* note 15) is deferred until part V.

⁵² The additional goal of maximizing the value of common stock is discussed later in this part.

⁵³ This proposition holds in a world where participants in the marketplace exhibit, systematically, general risk aversion; that is, where, for each unit of increased risk assumed, greater return is demanded. I assume the alternative assumptions of risk-neutrality or risk-avarice are poor a priori and a posteriori descriptions of reality.

in paying the asking price for either, as a firm will always be required to do if it pursues an opportunity.

The foregoing lesson is a powerful starting point for a mode-of-detriment inquiry, and yet it is not expressly adverted to, let alone well developed, in the case law rhetoric—even though, as shown by the implications of the constrained fact set developed in part I., a finding of detriment (that is, a finding that firm pursuit of a project would be better than value-neutral, plus the assignment of a property right) is, in opportunity cases, both a necessary and sufficient condition to a finding of performance-obligation applicability and conflict of interest. Moreover, the possibility of value-neutrality and its no-detriment implication call for an identification of non-value-neutral possibilities.

The analysis leading to identification of better-than-value-neutral opportunity fact patterns presented here is derived from the existence of imperfections in the exchange processes that coordinate resource distribution and allocation. Absent imperfections, the prices (that is, marketable value) of projects are set so as to eliminate greater-than-value-neutral opportunities. Because of imperfections, however, the present value of the future return stream of a return generating project may be greater than the costs, at least to some persons, of carrying or acquiring it. If such a person is assigned a property right (for reasons suggested in part III.B., *infra*) in the determinants of the project's return stream, capturing the project is of greater-than-value-neutral significance, and being deprived of it is a detriment.

a. Sunk Costs of Acquisition in Existing Projects

Assume that a firm's costs of assembling the factors of a return generating project, or some aspect or determinant thereof,⁵⁴ is equal to the present value of the project's future return stream. Suppose further that, immediately after purchase, the sum of the marketable values of the project factors, assuming each were to be sold in the separate market for the particular type of factor (that is, assuming the project were to be broken up), is less than the present value of the project's going-concern future return stream. This state of affairs is not unusual because the separate markets for factors, as contrasted with the market for going concerns, are influenced by discounts attributable to uncertainty about the return generating capacity of used factors and the inability of participants in the factors markets to costlessly access the information necessary to produce the going-concern returns generated by factor combinations. In such a situation, the firm has "sunk" acquisition costs in the project factors, but, so long as the present value of its going-concern future returns is greater than the breakup value of the factors, breakup value is irrelevant. Re-

⁵⁴ As suggested in note 8, *supra*, projects have components that may be separately acquired and viewed as subprojects. Throughout this paper, the phrase "return generating project" is used to include discrete subprojects.

ductions in the capitalized-going-concern-return value bring the firm closer to breakup value dominance. Therefore, even if an additional (or incremental) project—remembering that projects may be aspects of larger projects—is market value neutral (or worse) in isolation (that is, even if the present value of its own future return stream is equal to or less than its cost), the pursuit of such an incremental project may protect (or preserve) some amount of an existing project's excess of capitalized-going-concern-return value over its breakup value. Someone else's pursuit of the project may threaten such excess by reducing the magnitudes of the firm's future going-concern returns (or cash flows), by increasing the risk thereof, or by delaying the time of their realization. The question a firm with sunk costs in an existing project must ask then, in order to determine whether a new project has greater than neutral value significance, is whether the net cost of pursuing the incremental project (that is, its costs minus any additional capitalized-future-return value produced by it) is less than the amount of the excess of going-concern present value (over breakup value) that will be protected in an existing project. Put another way, the post-pursuit breakup value of the existing project (including the breakup value of factors purchased in pursuit of the incremental opportunity) must be less than such project's post-pursuit capitalized-future-return value (including new capitalized-future-return value added by pursuit of the incremental project). Attempts to protect demand for the firm's product or service or to preserve the return generating capacity of the firm's factors (such as supply arrangements or production technology) fall into the foregoing category of possibly greater-than-value-neutral opportunities.

An opportunity fact pattern does not fit this classification where an existing project's capitalized going-concern return value is equal to or less than the breakup value of assets carried to conduct it. In such circumstances, the firm's pursuit of an incremental, *new* opportunity that would be value-neutral (or worse) in isolation cannot be justified as greater-than-value-neutral on the theory that it protects some portion of the excess of an *existing* project's capitalized-future-return value over the latter project's breakup value.

b. Greater-Than-Zero Net Present Value of New Projects

A second situation in which pursuit of an opportunity can be a better-than-value-neutral move for the firm is where the purchase price (to be paid to the third party source of the opportunity) is less than the capitalized future return value that the project would have in the hands of the firm, if the firm were assigned a property right therein. This situation, referred to herein as having a greater-than-zero net present value, exists where the purchaser, as contrasted with the seller, can bring some enhancement factor, such as information, to bear upon the operation of the project so as to make its capitalized going-concern return stream worth more than what the third party source, who may not have risk-free ac-

cess to the enhancement factor, is asking. Moreover, it is not necessary that there be a spread between the breakup value and capitalized-future-return value of any *existing* firm project in order for the acquisition of a greater-than-zero net present value project to be greater than value-neutral for the firm. Such an opportunity is better than value-neutral when considered in isolation, that is, even when assessed without reference to the values of existing projects of the firm. Those who can discover and implement such value enhancement factors—who acquire the information and devise the plans necessary to do so—earn abnormal returns on their investment in opportunities.

c. Summary of Firm Effects

As far as the firm is concerned, then, greater-than-value-neutrality can attach to pursuit of an opportunity where (1) an existing firm project, because of the sunk costs of factors, has a capitalized going-concern future return value in excess of breakup value, whether or not the opportunity in isolation has a greater-than-zero net present value, or (2) where the opportunity would have a greater-than-zero net present value, whether or not any existing project exhibits the characteristics of condition (1). In the residuum of cases (where neither condition is met), pursuit of opportunities will be only value neutral (or worse) for the firm, even if it is assumed that the firm should be assigned a property right in the future return stream of existing projects and the opportunity project. But even where one of the two conditions is met, no detriment occurs as a result of the firm's not pursuing the opportunity unless the further judicial decision is made to assign to the firm a property right in the opportunity's protective effects on the value of existing projects (under condition (1)) or its value-enhancement effects (under condition (2)).

2. For Shareholders

In this section, the discussion is independent of whether capturing a return generating project would be better than value-neutral for the firm. Financial economics has drawn the veil on the marketable value interrelationships that exist between classes of securityholders within a single firm. A variety of decisions on both the asset and financial sides of the firm can result in shifts of wealth among classes of securityholders. Suppose that an opportunity in assets (a third party's willingness to sell or to buy assets) or an opportunity with respect to a firm's own outstanding securities (a third party's willingness to sell or to buy such securities) is the means by which firm managers can execute a decision that will shift wealth among the firm's securityholders. If an agent were to satisfy the third-party demand or supply by transactions for the agent's own account, an opportunity problem of the part I. constrained type would arise.

If a merely wealth-shifting opportunity is pursued by the firm, gain

to shareholders is at the expense of the debtholders. Hence, to categorize such an opportunity as belonging to the firm only because of its potential for wealth-shift gains to shareholders is to imply that directors' and officers' obligations call for preference of stockholder wealth over debtholder wealth. This would not be an unusual conclusion and is probably consistent with the differences (in the polar cases, at least) between the contractual nature of the two types of securities. Debt is highly and explicitly specified as to the amount, timing, and other attributes of consideration to be furnished by the firm, leaving very little need to supply implied terms of the obligations of firm managers toward debtholders. Equity is the very opposite. If preference for the wealth of shareholders is prescribed, an opportunity that would facilitate a wealth-shift gain for stock could be found to have greater-than-value-neutrality in terms of its effects on shareholders. The strategies by which wealth shifts in favor of shareholders can be implemented are quite varied, but all achieve their effects by changing the marketable-value-significant risk (called systematic risk) and expected-return features of stock in a favorable direction, while simultaneously moving the same attributes of debt in an unfavorable direction. (Opposite strategies can work against shareholders in favor of debtholders, and opportunities that would facilitate such strategies would *not* be given firm opportunity status.)

One example of how firm pursuit of an asset-side opportunity might be merely value-neutral for the firm and simultaneously more-than-value-neutral for shareholders is where the risk associated with returns to the firm from its operations is increased. This could be accomplished by substituting a low risk project for a high risk project, and the value shift from debt to equity would occur even if the substitute (high-risk) project was value-neutral for the firm. This occurs because the risk of returns on debt is increased, which raises the discount rate applied to the debt's expected returns.

Another illustration is a prorata repurchase of shares by the firm, which increases the risk associated with the firm's debt. Even non-prorata repurchases, such as targeted repurchases, may sometimes lead to a net marketable wealth increase for all shareholders, with possible net detriment to debt.

Shifts of wealth within the firm caused by firm action in favor of shareholders (and against debtholders) can occur only if debtholders, at the time they purchase their securities, do not perfectly anticipate future wealth-shifting probabilities and either insist upon protective covenants or adjust prices paid for (interest demanded on) the debt.

3. Variegation of Opportunities

What should become clear from the foregoing is that opportunity situations come in many different forms: increasing the scale of a present line of business (in the form of real assets or of financial assets issued by

third parties), selling a line of business, acquiring a new line of business, tapping or protecting sources and means of supply, and capturing or preserving demand. And these take into account only the operating-project and the product-market aspects of firm activities. On the capital structure (or financial) side of the firm, a firm may enhance its value (at least for some segment of investors, if not for the firm as a whole) by modifying its capital structure. Under certain circumstances, as has been suggested, the repurchase of its own securities may be an opportunity.⁵⁵ Finally, achieving a state of shareholder better-offness through changes in the characteristics of the market for the firm's securities, such as stimulation of a control share market, may also be an opportunity for firm investors.

B. *Property Right Assignment*

To identify the cases where, because of their preservation⁵⁶ or enhancement⁵⁷ effects on marketable value, opportunities could be beneficial to a firm or its shareholders is not to establish that a firm's not pursuing such an opportunity (or the agent's not being prevented from pursuing it) is a "detriment" to the firm.

In the methodology of the law, assignment of a property right in claim to a future stream of returns, or more pointedly in the means of generating or capturing such returns, is not justified merely by the fact that such an assignment would be of positive marketable value to a particular person. Take, for example, a person who, by virtue of the traditional elements or mechanics of transfer, is the unquestioned holder of all property rights entitling him to dispose of a security and to receive distributions from the issuer. Such a person is not automatically assigned a property right to the value-significance of information that will, upon discovery by the market, affect the price of his security, even though market price is a possible component of his security's future return stream.⁵⁸ So much the more difficult is it, then, to assign a property right in the determinants of a future return stream which have not been the subject of the traditional mechanisms of property right origination and transfer, such as those provided by contract, property, or fiduciary law. Yet that is precisely the task in the constrained version of the opportunity problem: the firm has not succeeded to property rights in the opportunity through traditional processes. This is clear as to standard contract- or property-law notions of how property rights are established. And, as has been shown in part I. and at the beginning of part III., be-

⁵⁵ Shleifer & Vishny, *Greenmail, White Knights, and Shareholders' Interest*, 17 RAND J. ECON. 293 (1986); Mikkelsen & Ruback, *An Empirical Analysis of the Interfirm Equity Investment Process*, 14 J. FIN. ECON. 523, 542-43 (1985); Dann, *Common Stock Repurchases*, J. FIN. ECON. 113 (1981).

⁵⁶ See *supra* part III.A.1.a.

⁵⁷ See *supra* part III.A.1.b. & 2.

⁵⁸ See, e.g., *Dirks v. SEC*, 463 U.S. 646 (1983) (creation of incentives to acquire and disseminate information is a policy objective to be considered in assigning property rights).

cause an agent's taking an opportunity is a decision neither purportedly on behalf of, nor creating commitments for, the firm, the agent's performance obligation (under fiduciary law) is not, without more, applicable to the agent's decisionmaking. Hence, there are no traditional contract-, property-, or fiduciary-law reasons, *separate from* assignment of a property right, that can be invoked to *justify* the assignment of the property right. Rather, the analytical priority is the other way around. The property right must be assigned on grounds separate from and in addition to the agent's performance obligation in order to justify the application of the performance obligation. To conclude that an opportunity is one that at least must be offered to the firm and that may not be pursued by an agent absent disinterested rejection is to conclude that there are sufficient grounds, necessarily other than the missing formal mechanics of claim creation and transfer, for assigning to the firm a property right in the nature of a call option on the opportunity. The option must be viewed as an informal, unrealized (but recognized) accretion to the wealth of the firm or its shareholders.

It is not surprising to find property rights assigned between parties for reasons other than, and sometimes in spite of, fulfillment of the traditional and more explicit conditions of claim transfer or origination. Prescriptive rights and the rights accruing under adverse possession are so recognized. And the right to private information that has value significance for a security is, as suggested earlier, sometimes assigned to persons other than the security's title holder. In all of these cases, no explicit private exchange transaction signals the assignment of the right. Rather, if the property right's existence is disputed, a judicial declaration of assignment substitutes for a private exchange transaction.

When one seeks recognition of an unrealized property right in the nature of an option to purchase a return generating project, as against another who asserts free access to the project, on what grounds might a court assign such a right, thereby recognizing a theretofore unrealized accretion to the option claimant's wealth?

A major concern that may be judicially cognizable is whether assignment of the option right will increase the likelihood that assets will move toward uses that will result in greater allocational and technological efficiency. If such a goal (end, objective) is given prescriptive status, the judiciary can use signals from market participants (that is, firms) themselves as to whether projects, or aspects of projects, will enhance technological feasibility or route resources into production efforts that offer the highest returns at their risk level. Firms show their own beliefs about these matters by devoting resources (including payments to personnel) to such subprojects as developing technology and production techniques, increasing scale, and establishing supplier relationships and customer good will. In this way, a firm gradually "buys" a call option to purchase future better-than-value-neutral opportunities by putting itself in a better position than others to exploit them—by laying the foundation

for making future opportunities better-than-value-neutral in the senses described in part III.A. In the face of evidence of a firm's successful prior expenditure of resources aimed at developing competence and advantage to exploit future project opportunities, a court's failure to show that firm—vis-à-vis a person who has not expended such resources—some sort of preference (that is, to assign a property right) with respect to pursuit of a relevant opportunity would be a disincentive to firms to facilitate allocative and technological efficiencies.

C. Detriment Factors and Invocation of the Agent's Performance Obligation

The fulfillment of the greater-than-value-neutrality condition,⁵⁹ and the existence of the incentive rationale for assigning a property right⁶⁰ form a combined basis for concluding that a firm's failure to secure a call option on the value-preserving or value-enhancing effects of an opportunity would be detrimental to the firm in a sense more palpable than simply being deprived of something nice to have. These detriment factors, in combination, supply a necessary basis for invoking a director's or an officer's performance obligation as the final component of the rationale for legal enforcement of the call option. For if, in the name of providing incentives to the pursuit of allocational and technological efficiencies, courts are willing to attach preferential property right significance, in the form of a call option, to the fact that a firm has previously devoted resources to the development of various methods of exploiting the greater-than-value-neutral effects of an opportunity, they are most likely to prefer the firm over its agents. By accepting broadly discretionary power to select the firm's most significant ends and means, firm agents, for considerations acceptable to them, have implicitly undertaken, in a manner that distinguishes them from other economic actors with whom the firm must contest in the marketplace for opportunities, to maximize the value of firm endeavors. In other words, from all agents who accept delegation of high-level decisionmaking discretion, the firm has purchased elimination of the risk that such agents will act to undermine the marketable value significance of opportunities for the firm, where it is also shown that the firm, to an extent greater than the agent (using his own resources), has devoted resources to creating a competence and capacity to give future opportunities greater-than-value-neutral significance. As between the firm and its agent, all of the ingredients for assigning the call option to the endowment of the firm are present. That being so, to deprive the firm of the positive value significance of pursuing the opportunity would be to plainly impose a true unrecouped opportunity cost on the firm.

⁵⁹ See *supra* part III.A.

⁶⁰ See *supra* part III.B.

D. Implications and Anomalies

If maximization of the marketable value of the firm or its shareholders is the normative end sought to be achieved by the substantive law governing agent pursuit of opportunities, the underlying analysis must be structured around the inquiries identified in part III.A.-C. As a purely positive matter, however, one observes very little explicit adherence to, or direct invocation of, such an analytical framework in judicial evaluations of the evidence in particular controversies. Instead, the heuristics litanized in part II. are used to evaluate the evidence. On the other hand, the tenor of the cases is that marketable value is a principal objective of the opportunity rule's present formulation. That would suggest the heuristics are mediate inquiries designed to facilitate factual evaluations according to a deeper, unspoken analytical framework, which has the content of part III.A.-C. but which courts are not articulating well, either because they are proceeding on intuitions that are, for them, ill-defined, or because they feel that the mediate, heuristic level of factual evaluation is about as refined as they can practically get. If so, the part II. tests are meant ultimately to verify conditions that are more sharply identified and interrelated within the framework of part III.A.-C., which should discipline the use of the heuristics and to which the courts should resort when the heuristics supply unsatisfactory responses.

IV. THE RELATION BETWEEN THE "STATE OF THEORY" AND THE IMPLEMENTATION OF THEORY THROUGH LEGAL RULE FORMULATIONS

The substantive law of an agent's liability with respect to opportunities appears quite structured in its heuristic expressions, yet it is diffuse and elusive as to its underlying analytical framework and justifications. This part investigates the extent to which greater explication of rationales, such as that proposed in parts III. and V., may be useful in rule formulation and application. The limits on the implementation of theoretical intricacies are also explored. I begin with a view of legal rule formation and then examine its implications for the law of firm opportunities.

Judges resolve actual controversies by using judicial algorithms, that is, sequences (or series) of evidentiary inquiries (or evaluations) designed to verify the presence (or absence) of the array of substantive-law conditions or elements required to furnish a foundation for property right assignments and liability. These algorithms and the conditions (or elements) sought to be verified thereby make up the content of rule formulations used by courts to test whether a particular controversy sufficiently resembles a rulemaking "model," around which the rule's supportive theory (that is, its justification or rationale) was originally developed. The model itself is founded upon a constrained portrayal of a controversy (that is, a fact set greatly shorn of detail), which highlights

the competing values at stake in a class of controversies which the pared pattern typifies. Other components of the model are (1) the goals (values, objectives) chosen to be pursued in resolving the constrained statement of the controversy, and (2) the hypotheses about reality,⁶¹ together with extensions thereof derived by necessary inference, from which a rule's likely effects, in terms of chosen goal achievement, are projected.

By implication, judicial examination of the facts of actual controversies for their resemblance to a rulemaking model is also an inquiry into whether such facts instead bear the marks of a "contramodel," wherein the justifications of a rule are most persuasively absent. The judicial algorithm for such testing is the vehicle for implementing a rule in particular controversies, where there are varying degrees of factual deviation from a rule's foundational model and where the goodness of the algorithm is judged by its sensitivity to such variations and its capacity to differentiate cases in a manner consistent with the "state of theory" developed from the model.

By "state of theory" I mean, at any stage of a rule's evolution over time, such things as: (1) the clarity and completeness with which normative values (goals, objectives) are identified, (2) the specificity with which operative assumptions about reality, and the logically necessary inferences therefrom, are stated, (3) the nature and content of such values, assumptions, and inferences, (4) the rulemaker's confidence in its value selections, assumptions, and inferences, and (5) the a priori prospects of detecting, through evidentiary examination, the factual conditions which, in light of such values, assumptions, and inferences, are required to be shown to justify property right assignments, conclusions as to detriment, and, ultimately, the imposition of sanctions.

If judicial problem-solving algorithms and the substantive law conditions of liability sought to be verified thereby are derived through a process similar to the foregoing, they cannot but be purified by attempts to better the "state of theory"—in the context of firm opportunity law, by identifying the objectives of making property right assignments, by distinguishing marketable and nonmarketable value objectives, and by critiquing, revising, and perfecting assumptions about when and how marketable value effects of opportunities are likely to be better than neutral for firms and when nonmarketable value effects may be prescriptively significant. In the process of devising rules for separating the vine from the must, it is important to continuously extend our understanding of the nature of the vine and the nature of the must, as well as the circumstances in which each is most likely to be present. As important, we

⁶¹ For example, in the context of the constrained opportunity pattern posited in part I., such hypotheses or assumptions would include the private objectives that normally motivate economic actors to act alone or pursuant to arrangements involving delegation, the functional relationships between the decisions of agents (that is, delegates) and the wealth shifts experienced by firms and their investors, and the likely reactions of economic actors to legal rules.

must continuously refine the subsidiary questions that can be asked to differentiate firm from nonfirm opportunities.

On the other hand, highly probabilistic factual circumstances, such as sunk costs, project-specific returns, abnormal return potential, gradual and unrealized accretion to firm value, and unsystematic (nonmarket) costs, were (in part III.) and will be (in part V.) discussed and posited as (at least) explanatory and (arguably eligible) normative bases for the identification of modes of detriment and the assignment of property rights necessary to activate an agent's performance obligation and to prescribe sanctions for nonobservance. These intensely speculative aspects of the "state of theory" regarding firm opportunities will produce uncertainties that encumber and complicate the task of implementing these highly refined theoretical tuitions through practicable judicial algorithms expressed as an array of factual inquiries and their subsidiary evidentiary requirements. Even under a better defined analytical framework and more sharply specified explanatory theory, these obstacles to implementation will persist in irradicably residual measure and perpetuate some of the heuristic grammar and expressions of current opportunity analysis.

The judiciary's simultaneous fetish for heuristics and failure to explain may be symptoms of a lack of a crisp analytical framework and a well-specified explanatory theory upon which to assign property rights, identify detriment, and invoke the performance obligation. It is also possible that the analytical framework and explanatory theory offered in parts I., III., and V. explain the unspoken thought structures and policy orientations implied by the coarser, less explicitly decomposed judicial rhetoric described in part II. Either way, if one can propound a more completely explanatory theory, built upon a more thorough analytical framework, the chances are enhanced of discovering what is (or should be) actually at work in the judicial mentality and what, if anything, currently lies hidden or at most intimated beneath the by-the-numbers, mechanical investigations performed according to the battery of tests described in part II. Perhaps, as suggested in parts III. and V., some of the rough edges can be chiseled off, and the gaps tuck-pointed, in the existing judicial analytical structure.

It is not unusual, however, to find lawyers and judicial decisionmakers dealing with the muck of reality by resorting to heuristic approaches, even though it is well known that such approaches create pitfalls. In many—dare one say "most"?—of the opportunity cases, the courts seem to be analytically at sea when they resort to the calculus of factors that has evolved in the reported opinions over the years. But, even if by some sort of intuition they are moving, however haltingly, toward a well-specified algorithmic formulation that seeks to discover in actual cases the presence of theoretically prescriptive conditions for property right assignments and value enhancement or preservation, we should still expect to find some imprecision in the case analysis. Even where the judicial decisionmaker is pursuing a well-disciplined and theo-

retically satisfying—perhaps even robust—approach to the decisionmaking process, identifying evidence of such factual states as sunk costs and greater-than-zero net present value will be tricky. Much of the theoretical inquiry will be necessarily probabilistic with respect to most opportunities. This does not suggest that theory should not be pressed to its most minutely specified state. Indeed, driving the development of justifications to more advanced states may, depending on the degree of complexity that surfaces at the theoretical level, be instructive as to how finely distinctions ought, or ought not, be drawn in particular cases, given the practical power of courts to devise rules and methods of detecting theoretically distinguishing features in a real controversy.

V. A SECOND TYPE OF DETRIMENT: DEPRIVATION OF NONMARKETABLE VALUE (IMPOSITION OF UNSYSTEMATIC COSTS)

There remains the nagging question of whether an opportunity ought to be deemed corporate because, for one reason or another, it suits the tastes or preferences of the firm's investors, or some class thereof, for nonmarketable values (satisfactions, goods). Suppose an agent's pursuit of a return generating project would have neutral marketable (or systematic) value significance for the firm; that is, pursuit by the firm would not prevent a detrimental reduction of the firm's prepursuit marketable, capitalized going-concern value⁶² or lead to the capture of a positive net present value.⁶³ Suppose also that pursuit of the opportunity would be value-neutral for all classes of the firm's securityholders.⁶⁴ But suppose still further that the firm's capture of the opportunity would facilitate a match between investor tastes and some aspect the firm's financial structure or operations.⁶⁵ Should that fact constitute a sufficient condition for

⁶² As demonstrated earlier, an agent's pursuit of an opportunity signals a detrimental decline in prepursuit firm value where: (1) the firm has sunk costs in an already existing project (that is, where the current breakup value of assets carried to pursue the project is less than the present value of the project's going-concern future return stream); the firm's pursuit of the opportunity would protect a portion of such present value; and further nonrepetitive costs to the firm of pursuing the opportunity are less than the amount of the break-up-value/going-concern-value spread protected; and (2) there are reasons for assigning to the firm a prepursuit property right in the opportunity.

⁶³ A positive net present value firm opportunity exists where (1) the costs of pursuing a new project are less than the present value of the opportunity's future return stream, and (2) there are reasons for assigning the firm a prepursuit property right in the opportunity.

Where neither the sunk costs condition nor the positive net present value condition prevails, pursuit of the opportunity is marketable (or systematic) value neutral, at least for the firm as a whole.

⁶⁴ The pursuit of a project that is value-neutral for the firm as a whole can, but need not be, value enhancing for particular classes of securityholders. For example, where a firm has debt outstanding, unexpectedly raising the risk level of the firm's asset project, without changing its value, may shift wealth from debtholders to shareholders. See T. COPELAND & J.F. WESTON, *supra* note 7, at 414-15.

⁶⁵ One such instance is where pursuit of an opportunity would cause the risk of its outstanding securities to match the risk preference of the securityholders. Another instance is where a share-

calling an opportunity a corporate one? I am hesitant to suggest that taste or preference mismatches alone should be prescriptively significant to assigning a property right or imposing a liability rule. It is regularly argued that the taste preferences of a firm's investors should generally be of no normative concern to its agents in choosing among return generating projects, so long as such decisions are marketable-value preserving or better. It is possible—the argument goes—for investors to satisfy any mismatch between their preferences and the investments they hold, where the mismatch is caused by changes (or, as important, the absence of changes) in the underlying asset-project or capital-structure of the firm or in other sources of nonmarketable value to securityholders, simply by trading (out of an unwanted position and into a desired position) in the markets for real or financial investments.⁶⁶ Therefore, I would be reluctant to conclude that the *firm's* pursuit of investor-preferred nontransferable satisfactions is of interest to an investor in financial assets, unless rather persuasive evidence of such interest appears in a particular case.

This is not to say that investors do not have taste preferences for such financial-asset related items as timing and uncertainty of future marketable returns. And investors do have project-specific personal human capital.⁶⁷ It is not difficult to accept, *a priori*, the assumption that investors typically exhibit varying preferences for this class of security-related features. The only problem with attributing any prescriptive significance to this category of admittedly prevalent preferences is the palliating assumption that investors have access to relatively complete markets in alternative financial assets that will suit their tastes.

There is another species of tastes, however, that is more difficult, *a priori*, to attribute, in any significant measure, to a "model" investor in financial assets. Such are the purely consumption satisfactions that, as a theoretical *possibility*, might be associated with investment in a security representing a claim to distributions from a specific return generating project.⁶⁸ Such satisfactions may sometimes be of interest to an investor in *real* assets. For example, one might become the proprietor of a farm and milk cows not only for the future stream (no pun intended) of marketable returns but also for the nonmarketable satisfaction of sharing the vegetative and bovine company. One might even be willing to sacrifice marketable returns for such nontransferable satisfactions.⁶⁹ But these

holder is also a labor factor of his firm and has sunk costs in his personal knowledge, training, and experience, which are "project specific." That is, the shareholder can, through direct compensation or distributions from his firm with respect to his shares, or both, capture the maximum returns from his specific human capital only by serving a firm holding a project like that offered by a particular opportunity. A third illustration is where an investor wishes to hold securities in a firm whose asset projects do not pollute or are managed by blue-eyed persons.

⁶⁶ See, e.g., E. FAMA & M. MILLER, *THE THEORY OF FINANCE* 67-77 (1972).

⁶⁷ See *supra* note 65 (second instance). An investor may be willing to sacrifice marketable values to satisfy such a preference.

⁶⁸ See *supra* note 65 (third illustration).

⁶⁹ Three situations in which marketable value might be sacrificed are: (1) where an asset pro-

are peculiar things to say, as a mean estimate, about people who buy and hold *financial* assets, if we are correct in our normal assumption about the major objectives sought by the typical person in the latter decision-making context, namely, that an investor normally does not expect to capture, by means of holding securities, consumption satisfactions, such as a feeling of warmth from owning claims to distributions from a project that manufactures a particular product or is managed by a particular person or in a particular way. Economists recognize the theoretical possibility of such preferences and their conceivable significance for the performance obligation of firm agents, but the existence of such conditions, which do not lie within the normal assumptions about the objectives of a model securityholder, would have to be shown by special evidence.

One might find a firm where the investors reveal that the firm is generating nonmarketable satisfactions of one category or another, and perhaps that should, so long as further conditions are met, make a difference in determining whether a marketable-value-neutral (or worse) opportunity should be deemed corporate because it satisfies such revealed preferences. But taste preferences can be a sufficient condition for calling an opportunity a corporate one only if it can be concluded that investors' preferences can and must be met by the *firm*, that is, only if (1) the investors share taste preferences⁷⁰ and cannot trade away from the taste mismatch created by the diversion of an opportunity, either because transfer is forbidden or because the market set of alternative opportunities is incomplete, or (2) the aggregate transaction costs incurred by those investors who switch out of their investments because the firm failed to pursue an opportunity would be greater than the transaction costs incurred by those who would switch if the firm pursued the opportunity. We might conclude from explicit evidence of the existence of nonmarketable value preferences and the fulfillment of these conditions that investors want their managers to pursue return generating projects that suit the tastes of investors by allowing investors to capture the nonmarketable values or goods, even where such decisionmaking would not protect or enhance (that is, would not be greater-than-value-neutral), but might even sacrifice, the marketable value of the firm or of some class of its securities.

Unified tastes are likely to be found among the equityholders of a closely held firm, at least at the outset of the firm's existence. Similarly, nontransferability is frequently a constraint imposed, formally or infor-

ject is chosen that offers an inferior rate of return for its risk class, (2) where a project is operated at less than technologically feasible efficiency, and (3) where the firm's assets or securities are given away.

⁷⁰ Where there is a disparity of preferences, the problem, where transfer is not feasible, becomes quite intractable in the absence of (1) cardinality of taste evaluation, (2) a system of attaching money significance to the preference fulfillments and disappointments experienced by different groups within the shareholder collective, plus an acceptance of Kaldor-Hicks notions of aggregate better-offness, or (3) an option for those whose tastes would be frustrated by firm pursuit of an opportunity to cash in their shares.

mally, upon the equity of such a firm.⁷¹ Besides, it is not difficult to accept the probability that agent/shareholders of closely held firms will have sunk costs of human capital which are "project specific."⁷² These likelihoods suggest that treating an opportunity as belonging to the firm, simply in light of its capacity to satisfy investor tastes, would be most likely to be justified in the context of the closely held firm.

As for completeness of the markets in alternative investments (to which dissatisfied investors could flee if their firm did not pursue an opportunity that would have matched their preferences), there is some evidence that might support the hypothesis that the securities of particular issuers are unique, but that is not a dominant conjecture.⁷³

VI. CONCLUSION

If a survey were taken of just the last decade or so, it would show a goodly number of reported opportunity cases in the United States. There is more than just a trickle of litigation in this area, and the volume of controversies itself requires an explanation in terms such as barriers to promulgation of the law, the law's sensitivity to case-specific factual variations, or the law's analytical and explanatory veridancy.

Agents and principals may not be getting wind of the law, and their natural intuitions, uninformed by knowledge of the law and based purely on the expectations entertained by typical persons in agent-principal relationships, may be systematically contrary to the law's position. Or maybe the law in this area, by permitting inquiry into a relatively large array of factual conditions, invites judicial consideration of evidentiary fine points, thereby tempting potential litigants to believe that their cases can always be differentiated from past decisions. Or, finally, as suggested throughout this article, the law may still be in its formulaic (as contrasted with chronological) infancy, operating from yet primitive intuitions and heuristics and seeking a better defined analytical framework and more sharply specified explanatory theory. It is not unusual to find a higher volume of litigation during the period in which a rule is still in developmental turmoil.

⁷¹ It has been recognized that the reasons for forming a closely held firm (as evidenced by the explicit constraints imposed voluntarily upon its form) may imply a desire on the part of the participants to engage in behavior that does not maximize marketable value of the firm. *See generally* Fama & Jensen, *Organizational Forms and Investment Decisions*, 14 J. FIN. ECON. 101 (1985).

⁷² *See supra* note 65 (second instance).

⁷³ *See generally* Asquith & Mullins, *Equity Issues and Offering Dilution*, 15 J. FIN. ECON. 61, 61-63 (1986).

