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Self-Dealing, Corporate Opportunities and the Duty of Loyalty - a US, UK and EU Comparative Perspective

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Abstract

The paper offers a comparative perspective on the duty of loyalty – encompassing both rules that govern self-dealing and corporate opportunity transactions. It compares the evolution of these two sets of rules in several European jurisdictions and in US Delaware law. The paper begins by comparing the approach to regulating self-dealing and related party transactions under both common law (namely the US and UK) and civil law regimes (focusing on continental Europe). It then turns to the legal development of corporate opportunity rules, and contrasts the approach to corporate opportunities under US law to the less-developed jurisprudence on corporate opportunities in civil law jurisdictions.

Corradi and Helleringer note tensions between the evolution of the law governing self-dealing transactions at the European level, and the lack of harmonization on rules addressing corporate opportunities and continuing divergences in corporate opportunities doctrine across EU jurisdictions. They observe a relaxation of the duty of loyalty in US Delaware law, while there is an asymmetric evolution of its two components, self-dealing and corporate opportunities, in the European context. On the one hand, self-dealing rules have existed in European corporate laws for a long time and have been substantially relaxed in Europe in recent times as they have in the US. On the other hand, corporate opportunities rules have been introduced in most European jurisdictions only throughout the last two decades – without an express possibility of a waiver such as the one granted by DGCL s. 122(17).

The convergence of self-dealing rules may have been facilitated by the harmonization of EU financial market law, which in turn has not affected corporate opportunities rules. Economic agency theory provides a rationale for a hypothetical convergence of self-dealing and corporate opportunities rules, based on their economic function.

Keywords: self dealing, corporate opportunities, related party transaction, conventions réglementées, duty of loyalty, fiduciary duties, corporate governance, US, UK, EU.

JEL Classifications: K22, K42

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Self-Dealing, Corporate Opportunities and the Duty of Loyalty - a US, UK and EU Comparative Perspective[1]

Marco Corradi[2] and Genevieve Helleringer[3]

There are several inherent challenges when comparing the duty of loyalty within different legal systems. First, different legal systems derive loyalty rules from distinct areas of the law. For instance, in the common law, directors' duty of loyalty derives from trust law.[1] By contrast, in many civil law jurisdictions,[2] loyalty rules derive from the statutory rules on corporate directors' interest,[3] or develop in case-law, as judges are able to refer to such principles as corrective mechanisms.[4] Secondly, the Anglo-American tradition has influenced other jurisdictions in this area of the law.[5] Institutional investors in equity have come to request higher protection for their investments and directors' duty of loyalty[6] is an important component of such protection.[7] Thirdly, because of the different origins of such rules and because of subsequent legal transplants from Anglo-American systems into civil law ones, there might have been a degree of "confusion

[1] A version of this paper will be published as chapter 10 in the forthcoming RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE (Afra Afsharipour & Martin Gelter eds, 2021)

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[1] Leonard Sealy, *The Director as Trustee*, 25(1) CAMBRIDGE L.J. 83 (1967); Joseph W. Bartlett & Kevin R. Garlitz, *Fiduciary Duties in Burnout/Cramdown Financings*, 20 J. CORP. L. 593, 599 (1995).

[2] Martin Gelter & Geneviève Helleringer, *Fiduciary Principles in European Civil Law Systems in* OXFORD HANDBOOK OF FIDUCIARY LAW 583–602 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds. 2018).

[3] As in the case of Italy, where the Civil Code original provision was known under the name of "*conflitto di interessi degli amministratori*" (directors' conflict of interests). For an in-depth analysis of the provision, see LUCA ENRIQUES, IL CONFLITTO DI INTERESSI DEGLI AMMINISTRATORI DI SOCIETA PER AZIONI (2000).

[4] For a sophisticated explanation of the French and German approaches, see CARSTEN GERNER-BEUERLE & MICHAEL ANDERSON SCHILLIG, COMPARATIVE CORPORATE LAW 565–74 (2019).

[5] *See* Holger Fleischer, *Legal Transplant in European Company Law – The Case of Fiduciary Duties*, 2 EUR. COMPANY & FIN. L. REV. 378 (2005).

[6] Director's duties are often deemed owed to the corporation, but the matter is disputed and under evolution; *see* Martin Gelter & Geneviève Helleringer, *Lift Not the Corporate Veil! To Whom Are Directors' Duties Really Owed?*, 3 U. ILL. L. REV. 1069(2015).

[7] FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1996).

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of tongues."[8] Nowadays, the terms "duty of loyalty," "conflict of interest," "self-dealing," "corporate opportunities," "directors' duty not to compete" and their respective translations exist in most jurisdictions of developed economies.[9]

Nonetheless, there is some doubt as to whether the semantic is consistent across the board. Apart from the nuances inherent in each language, when a given rule is developing within a specific jurisdiction, it often follows unpredictable paths determined by the specific cases brought to the attention of the courts and other institutional variables.[10] This is true not only when one compares common law to civil law jurisdictions, but also when one compares different common law jurisdictions with each other, or different civil law jurisdictions with each other. For instance, the "duty of loyalty" law has distinct features in the UK and the US.[11] Therefore, trying to adopt cross-border common legal definitions may never be entirely possible. Finally, the Anglo-American comparative legal culture – based on the economic analysis of the law – has largely structured the debate on this subject.[12] However insightful it is, such an approach may downplay the importance of the presence of different legal roots. As a consequence, it misses

[8] The problem of inconsistency among semantic fields may be said to be inherent to normative language. *See, e.g.*, STEPHEN FINLAY, CONFUSION OF THE TONGUES: A THEORY OF NORMATIVE LANGUAGE (2014) (analyzing the meaning and use of the words "ought," "good" and "reason" in the philosophical debate). This phenomenon is even more meaningful in the legal context, where legal terms recall sophisticated concepts, to which a complex *acquis* of case law and jurisprudential interpretation is connected.

[9] *E.g.*, Respectively in French "*devoir de loyauté*" and "conflit d'intérêts"; in Italian "*dovere di lealta*" and "*conflitto di interessi.*"

[10] First, any time a court analyzes a new case, it enters in a completely new universe. Second, there are notable differences in terms of procedural, decision-making, rules in common law versus civil law countries. This is true with reference to the rule of precedents, the role of judicial dissent, and the role of economics analysis of the law. *See* Vincy Fon & Francesco Parisi, *Judicial precedents in civil law systems: A dynamic analysis* 26 INT'L REV. L. & ECON. 519 (2006); Michael Kirby, *Judicial dissent - common law and civil law traditions,* 123 L. Q. REV. 379 (2007); Richard Posner, *Law and Economics in Common-Law, Civil-Law, and Developing Nations*, 17 RATIO JURIS 66 (2004). Such institutional differences among legal families – which may well show further diversification within legal systems members of the same families – is indeed particularly meaningful. Therefore, even in the unlikely hypothesis that the same exact case was decided by court belonging to different judicial systems, it would be likely to observe the same outcome.

[11] DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW (2018); Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairnes*s, 88 FORDHAM L. REV. 939 (2019).

[12] One of the most influential publications on comparative corporate law, REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 4 (Reinier Kraakman ed., 3rd ed. 2017), provides, in the words of its authors, "a *common language* and a general *analytic framework* with which to understand the purposes that can potentially be served by corporate law." Nonetheless, it is also true that most of the functional economic analysis employed in the book has been conceived by Anglo-American authors within the Anglo-American legal systems.

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idiosyncratic institutional[13] and sociological[14] dynamics that bear directly onto the reality of the legal system and the way it operates.

With awareness of all the above-mentioned limits, we propose an analysis of the two major sets of rules that are usually understood as falling under the umbrella of the duty of loyalty: on the one hand self-dealing rules and related party transactions rules; on the other hand, corporate opportunity rules and the prohibition on competition with the corporation. We find that despite certain similarities in function of the two above-mentioned sets of rules (e.g., containing agency costs), the attention of legislatures and of courts has mostly focused on self-dealing and related party transactions in recent times, especially in Europe.[15] A potential explanation may reside, on one hand, in the recent introduction of corporate opportunity rules in most continental Europe jurisdictions despite the absence of harmonization or debate on the taking of opportunities at the EU level[16] and, on the other hand, in a sort of path dependency at the level of the legislative and judicial debate, which has focused on self-dealing for several decades.[17] In the US, the most recent debate on corporate opportunity rules has mostly focused on the introduction of corporate waivers to this rule.[18]

We also believe that the legal rules mentioned above and comprised within the boundaries of directors' duty of loyalty present structural differences. Therefore, we divide our analysis in two sections, whose titles stress such difference. Section 1 deals with cases of directors' involvement on each side of corporate transactions, i.e. cases of self-dealing and of related party transactions. Section 2 deals with directors' entrepreneurial activity outside the boundaries of the corporation, i.e. corporate opportunities and directors' duty not to compete with the corporation. Section 3 concludes.

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[13] For examples of comparative strength of enforcement mechanisms or the role of criminal law, comp. Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. CO. & FIN. L. REV. 491, 518–23 (2007).

[14] For examples of clubby relations in national corporate elite, see *Lagardère: No, no Arnaud. Emmanuel Macron should look to curb France's clubby corporate relations*, FINANCIAL TIMES (Aug. 27, 2019), www.ft.com/content/96b40af4-8282-3095-939e-6b7a785c82ce.

[15] *Infra* Section 1.1.

[16] *Infra* Section 1.2

[17] *Infra* Section 2.

[18] See for instance Gabriel Rauterberg & Eric Talley, *Contracting out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers,* 117 COLUM. L. REV. 1075 (2017).

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1. DIRECTORS' INVOLVEMENT ON EACH SIDE OF CORPORATE TRANSACTIONS: SELF-DEALING AND RELATED PARTY TRANSACTIONS

It is not uncommon for corporations to enter into contracts with parties with whom they are connected, such as dominant shareholders, board members or executives. Such transactions limit the need to explore the market and may thereby limit transactions costs. In other words, they can create opportunities for efficient transactions and improved allocation of resources, typically when outside counterparties are not readily available for value enhancing transactions.[19] However, the connection between the contracting parties means that insiders are effectively influencing both sides of the transaction: the party with which the corporation is dealing is in a position to affect the corporation's decision to enter into the contract. If the purchaser of assets is also a director of the selling company, he will have a say in setting the price; similarly, a service provider who is represented on the board will also be involved in determining the scope and budget of the services to be provided. Such insiders may potentially secure better terms for themselves than they would get following arm's-length bargaining. Known as self-dealing transactions[20] – or as "related-party" transactions (RPTs) by reference to accounting definitions[21] – such contracts are instruments through which value may be tunneled away from the company.[22]

It should be stressed that, as some legal requirements apply to "related-party" transactions only, the law may in effect treat differently two tunneling techniques that provide the same outcome. This situation creates a risk of tunneling arbitrage. For instance, if a legal system provides that the procedural safeguards for RPTs have to be followed in the case of parent-subsidiary mergers, while much looser rules apply to tender offers initiated by the dominant shareholder and followed by a squeeze-out (again executed other than via a merger), the latter will be the

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[19] *See* Luca Enriques, Gerard Hertig, Hideki Kanda, & Mariana Pargendler, *Related-Party Transactions* in ANATOMY, *supra* note 12, at 145, 146.

[20] Andrei Shleifer & Robert Vishny, *A Survey of Corporate Governance*, 72 J. FIN. 737, 752 (1997) (referring to "managerial self-dealing, such as outright theft from the firm, excessive compensation, or issues of additional securities … to the management and its relatives"); Luca Enriques et al., *id.*, at 145 n.10 ("Self-dealing typically refers to purchases or sales of assets, goods, or services by related parties").

[21] Accounting definitions usually restrict the scope of related-party transactions to contracts entered into between the company and an entity related to a given director, even if some transactions outside this perimeter may qualify as conflict-of-interest transactions, see, e.g., Luca Enriques, *Related Party Transaction*, *in* OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 506, 513–14 (Jeffrey Gordon & Wolf-Georg Ringe, eds., 2015).

[22] *See* Simeon Djankov et al., *The law and economics of self-dealing*, 88 J. FIN. ECON. 430 (2008).

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preferred avenue to freeze out minorities.[23] Tunneling practices have been observed with a welfare enhancing effect, in Russia or Venezuela for instance, in reaction to ill-functioning public institutions, featuring arbitrary governmental expropriation or punitive tax system in the hands of corrupted officials.[24] Such practices may also persist because of path dependence in jurisdictions in which the institutional environment has improved only quite recently, like Italy or South Korea.[25] In countries with healthy institutions, the agency relationships between managers and shareholders often creates a dynamic in which agents will try to appropriate as much value as they can get away with, after having taken into account the probability of detection and punishment. As a way for fiduciaries to appropriate wealth, rather than sharing it with other investors, self-dealing can be practiced under the guise of legitimate business transactions.[26]

A number of jurisdictions have implemented provisions that address self-dealing transactions specifically. Some operate often via accounting norms. [27] For example, accounting standards, including the US GAAP and the International Financial Reporting Standards (IFRS), provide for disclosure with this type of transactions.[28] In addition, the UK has for a long time provided for procedural safeguards and immediate disclosure of larger self-dealing transactions in listed companies.[29] Wealth tunneling via RPTs contributed to the financial crisis that plagued Asia in the late 1990's.[30] Since then, and under the influence of international economic organizations

[23] Courts in Delaware used to treat treated tender offers more leniently than mergers, until they recognized that the two transaction forms are functionally equivalent. *See, e.g.*, Suneela Jain, Ethan Klingsberg & Neil Whoriskey, *Examining Data Points in Minority Buy-Outs: a Practitioners' Report*, 36 DEL. J. CORP. L. 939, 941–48 (2011). Legal scholars' criticism of Delaware's double approach nudged the Court to acknowledge their functional equivalence. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003); Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005).

[24] Enriques, *supra* note 21, at 506–12.

[25] *See* Marcello Bianchi, Luca Enriques & Mateja Milic, *Enforcing Rules on Related Party Transactions in Italy: Securities Regulator's*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 477 (Luca Enriques & Tobias Tröger, eds., 2019); Kon Sik Kim, *Related Party Transactions in East Asia*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 285 (Luca Enriques & Tobias Tröger, eds., 2019).

[26] By contrast with appropriation of private benefits via excessive compensation.

[27] Enriques, *supra* note 21, at 506–12.

[28] *See* RESEARCH AND DEV. ARRANGEMENTS, Statement of Fin. Accounting Standards No. 57, (Fin. Accounting Standards Bd. 1982); INTERNATIONAL ACCOUNTING STANDARDS BOARD, International Accounting Standard No. 24, (2010). No mention of materiality is made in the International Accounting Standard 24. However, it is an overarching principle of IFRS that disclosure is only to be made when it is material. *See* International Accounting Standards Board, International Accounting Standard No. 1, ¶ 31 (2011) ("An entity need not provide a specific disclosure required by an IFRS if the information is not material").

[29] *See* PAUL L. DAVIES & SARAH WORTHINGTON, GOWER & DAVIES PRINCIPLES OF MODERN COMPANY LAW 689–90 (Sweet & Maxwell eds., 9th ed. 2012).

[30] Simon Johnson et al., *Corporate governance in the Asian financial crisis*, 58 J. FIN. ECON. 141 (2000).

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such as the OECD and the World Bank,[31] corporate governance mechanisms developed, including the regulation of RPTs.[32] India and a number or other Asian countries[33] have recently broadened the scope of the rules and tightened their content, namely requiring approval by the majority of the minority for certain transactions.[34] Sales of assets below market price remain, however, a feature, in the context of state owned enterprises in particular.[35]

The EU's recently revised Shareholder Rights Directive (SRD), which regulates corporate governance aspects of European listed companies, [36] introduced a new set of provisions on transactions with related parties. The Directive required an *ex ante* review of self-dealing transactions through public disclosure and approval by either a shareholders' meeting or by the board.[37] This regime, which might have been modelled on the UK's listing rules (applicable to listed companies only), is not dissimilar from the Italian regime that was adopted for publicly traded companies in 2010.[38] It also has many common elements with the French mechanism, known as *conventions réglementées* ("regulated conventions"), that has been in place since 1863, with periodical amendments of which the most recent were introduced in 2014.[39] While French law does not include a materiality threshold, transactions "within the ordinary course of business" are exempted from regulation[40] and the regime applies to both listed and non-listed

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[31] The World Bank's Doing Business Report has been instrumental in focusing lawmakers' minds on improving RPTs laws by ranking countries, inter alia, according to how strictly they regulate them (according to a methodology derived from Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430 (2008)). *See Doing Business 2017 Equal Opportunity for All*, WORLD BANK GROUP 66 (14th ed. 2016), available at www.doingbusiness.org.

[32] Dan Puchniak & Umakanth Varottil, *Related Party Transactions in Commonwealth Asia. Complexity Revealed*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 327 (Luca Enriques & Tobias Tröger, eds., 2019).

[33] *See, e.g.*, Organisation for Economic Cooperation and Development (OECD), *Guide on Fighting Abusive Related Transactions in Asia*, 25–31 (2009).

[34] For additional elements of comparison, see THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS (Luca Enriques & Tobias Tröger, eds., 2019).

[35] When Coal India sold coal below market prices, a UK hedge fund engaged in an activist campaign. *See TCI in legal threat against Coal India*, FINANCIAL TIMES (Mar. 13, 2012), www.ft.com/content/7e70ca02-6d12-11e1-ab1a-00144feab49a.

[36] Shareholder Rights Directive (EU) 2017/828 of 17 May 2017, Amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

[37] *Id.*, art. 9c (4).

[38] *See* Regulations Containing Provisions Relating to Transactions with Related Parties, Resolution no. 17221 (2010), *amended by* Resolution no. 17389 (2010).

[39] These provisions relate to public limited companies (*sociétés anonymes* or "SA"). Similar provisions exist for other corporate forms, such as limited partnerships with share capital (*sociétés en commandite par actions*) (CODE DE COMMERCE [C. COM.] art. L. 226-10 (Fr.)) and private limited liability companies (*sociétés à responsabilité limitée* or "SARL") (CODE DE COMMERCE [C. COM.] art. L. 223-19 (Fr.)).

[40] *See* Geneviève Helleringer, *Related Party Transactions in France: A Critical Assessment*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 400 (Luca Enriques & Tobias Tröger, eds., 2019).

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companies.[41] By contrast the amended Shareholder Rights Directive will require an in-depth change in German law, which had adopted a different approach to policing assets tunneling, based on a codified law of corporate groups, imposing stringent liability rules against the directors of the parent company and the subsidiary.[42]

This section will focus on transactions giving rise to a transfer of resources[43] between directors and the company to which they owe fiduciary duties.[44]Given persistent differences, it reviews in turn the requirements and practices in common law jurisdictions and civil law jurisdictions, with a particular focus on European jurisdictions and the impact of EU law.

1.1 Self-Dealing in the Common Law

In the common law, the duty of loyalty owed by fiduciaries has traditionally structured the boundaries of lawful behavior. This section shows that, as the law of self-dealing developed, it gained some autonomy from the strict enforcement of the duty of loyalty.

1.1.1 The common law tradition and the standard of loyalty

1.1.1.1 English law

Historically, the UK adopted the "no-conflict" rule[45] that bans directors from entering conflicted transactions.[46] Lord Cranworth L.C. provided what became the classic formulation of the rule in *Aberdeen Ry. v. Blaikie*:[47] "[n]o one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which

[41] Rules are enshrined in articles L. 225-38 to L. 225-43 of the Commercial Code, which relate to public limited companies (*sociétés anonymes* or "SA") in general, whether listed or not. Similar provisions exist for other corporate forms, such as limited partnerships with share capital (*sociétés en commandite par action*) (article L. 226-10 of the Commercial Code) and private limited liability companies (*sociétés à responsabilité limitée* or "SARL") (article L. 223-19 of the Commercial Code).

[42] See Klaus Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 45 (2011) (referring to the limited number of jurisdictions that follow the German approach [Portugal, Brazil, Croatia, Slovenia, and Albania], or adopted it for a period [Hungary and the Czech Republic]).

[43] A fiduciary may pay for the authorization to capture a corporate opportunity, but this does not entail a transfer of resources from the company to the fiduciary.

[44] Executive compensation is governed by specific rules.

[45] *See, e.g.*, Paul L. Davies, *Related Party Transactions: U.K. Model* n. 4 (ECGI Law Working Paper No. 387/2018), https://ssrn.com/abstract=3126996 (focusing on the law of England and Wales as representative of UK law).

[46] For an historical overview of the no-conflict rule, *see* Tuch, *supra* note 11, at 945 n. 28.

[47] 1 Macq. 461.

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may possibly conflict, with the interests of those whom he is bound to protect."[48] In addition, where the rule operates, "no inquiry on [the merits of the conflicted transaction are] permitted."[49] Any self-dealing transaction is voidable, and directors cannot salvage a self-dealing transaction by demonstrating that the bargain is fair to the company. The rule requires directors to act in the principal's sole interests.[50]

In 2006 the UK Parliament codified corporate fiduciary duties in the Companies Act legislation.[51] The relevant sections of the Companies Act did not substantially alter directors' fiduciary obligations relevant to self-dealing, but rather reproduced the practical effect of the common law no-conflict rule.[52] The statutory duties are "based on" rules and principles under the common law pursuant to Section 170(3) of the Companies Act: the Act makes constant reference to common law when setting general principle. Such codification style is inherently different from the one usually adopted in civil law jurisdictions where precedents are not binding in most cases.

1.1.1.2 US law

The US – and more particularly its most corporate-friendly jurisdiction for company law, Delaware – departed from the "no-conflict rule" in the late nineteenth century and adopted a "fairness test,"[53] under which the onus is on directors who are on both sides of a transaction to demonstrate their utmost good faith "and the most scrupulous inherent fairness of the bargain."[54] That is to say, is the process equivalent to an arm's length transaction?[55] Courts assess fairness by reference to both the price and dealing, even if it only constitutes one test.[56]

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[48] *Id*.
[49] *Id.* at 471-72.
[50] The rule is also known as the "sole-interest rule." *See* John H. Langbein, *Questioning the Trust-Law Duty of Loyalty: Sole Interest or Best Interest*, 114 YALE. L.J. 929, 931 (2005).
[51] Available at www.legislation.gov.uk/ukpga/2006/46/contents.
[52] For further analysis, *see* Tuch, *supra* note 11, at 946.
[53] For a fuller analysis of the differences between US and English law summarized in this section, see Tuch, *supra* note 11. *See also* David Kershaw, *The Path to Fiduciary Law*, 8 NYU J. L & BUS. 395, 439–40 (2012).
[54] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).
[55] *See* Valeant, 921 A.2d 735 (Del. Ch. 2007) ("The process pursued by the directors was deeply flawed with self-interest and no way substituted for arm's-length bargaining.").
[56] *Weinberger*, 457 A.2d at 711 ("However, the test for fairness is not a bifurcated one as between fair dealing and fair price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.").

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As Tuch argues, "[b]oth fiduciary rules require strict loyalty, imposing liability for self-dealing, but provide multiple exceptions."[57] The English no-conflict rule enables companies to determine when and how the rule may be departed from, while the US "fairness test" rule specifies the exception, whose requirements turn out to be very strict.[58]

1.1.2 Similarity of practices in the UK and the US: the centrality of approval by neutral or disinterested directors

A standard provision in the Articles of Association of English companies requires directors who wish to engage in a transaction in which they have an interest to disclose its nature and extent, and to obtain approval from the disinterested directors.[59] In the US, a similar approach has developed, as courts expressly recognized that disinterested directors could approve self-dealing.[60] Empirical findings show that under both the UK and US rules, interested directors tend to favor approval by neutral or disinterested directors.[61] As Tuch notes, "[]n their operations, the rules closely mirror one another: they enlist neutral directors to patrol self-dealing, a commercially sensitive response."[62]

1.2 Self-Dealing in Continental European Jurisdictions

In contrast to the common law world, the duty of loyalty has never been the starting point in Continental Europe.[63] More recently, EU Law has been a driving force, shaping self-dealing law around mostly procedural requirements.[64] The effect of such requirements remains disappointing, namely because of under-involvement of independent third parties.[65] The traditional "club"

[57] Tuch, *supra* note 11, at 942.
[58] *Id.* at 942-943. As Tuch explains, there is an ongoing debate assessing whether the UK or US framework is more effective. *See id.* at 941.
[59] Companies Act 2006, § 175 (UK).
[60] *See* Tuch, *supra* note 11.
[61] *See id.* at 968–76.
[62] *Id.* at 943.
[63] Martin Gelter & Geneviève Helleringer, *Fiduciary Principles in European Civil Law Systems in* OXFORD HANDBOOK OF FIDUCIARY LAW 587, 587-89.
[64] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017, Amending Directive 2007/36/EC with regards to the encouragement of long-term shareholder engagement. The Directive requires Member States to introduce tougher rules on related party transactions by June 2019, including rules on approval, public announcement, and optional fairness reporting.
[65] While the main feature of the original proposal was a mandatory ratification of significant RPTs by outside shareholders after full disclosure and independent fairness assessment, the final legislative compromise made both

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culture in Continental European business had long opposed any reform seeking to tighten the grip on tainted transactions: it could not oppose the latest attempt but has watered down the restrictions initially contemplated by the European Commission.

1.2.1 Domestic and European requirements

1.2.1.1 Domestic civil law

In civil law jurisdictions, duty of loyalty was not the starting point: loyalty is usually not mentioned in the code and is hardly ever relied upon by courts in the context of transactions between directors and the company.[66] In some jurisdictions, commercial codes have included procedural rules setting limits on self-dealing transactions since the end of the 19th Century (France[67] and Italy).[68] Recent developments in domestic civil law result from the transposition of EU law that further marginalize the role of the duty of loyalty[69] in the monitoring of self-dealing and the importance of procedural requirements.[70]

1.2.1.2 EU law

As mentioned before, after a lengthy process starting in April 2014, the recently amended Shareholder Rights Directive (SRD) has harmonized procedural requirements within Europe.[71] The final version of the directive is evidence of the protracted agreement process, as it leaves Member States far more discretion in the way they can implement the directive. Typically, Member States can decide whether shareholders or directors must approve RPTs.[72] However, aspects of the Article 9c SRD regulating related party transactions also remain stricter than what had been in place in most Member States.[73]

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procedures optional, and recognizes that the administrative or supervisory body may give the fairness assessment or the consent, provided that the related party cannot take advantage of its dominant position in the procedure.

[66] By contrast, the duty of loyalty has been referred to in the context of business opportunity cases, see *infra* note 122 and accompanying text.

[67] Helleringer, s*upra* note 40, at 400.

[68] The Italian Commercial Code contains a rule requiring directors to disclose their interests in the transactions concluded by the company and preventing directors from voting in such board decisions. CODICE DI COMMERCIO [C. COMM.] art. 150 (Italy).

[69] As already stressed, this is also true for the UK, which had been an EEC and later EU Member State from 1973 till 2020, including in the UK despite its common law heritage.

[70] *Supra* note 64 and 65.

[71] *Supra* note 64.

[72] *Supra* note 65.

[73] *Supra* note 36.

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First, “related party” has the same meaning in the directive as in the vocabulary of accounting,[74] and extend therefore to transactions not do not necessarily involved a significant shareholder, and to transactions between a company’s subsidiaries and a related party. Although not explicitly stated, one can also expect the term “transaction” to be used in accordance with this accounting standard, meaning that Article 9c SRD will cover a broad range of transactions. As such, it was necessary to allow Member States to exclude transactions that do not pose a real risk of potential abuse.[75]

Secondly, article 9c only affects “material” transactions, which can be defined by the Member States based on quantitative ratios. Non-material transactions with the same related party are aggregated in any 12-month period. Member States may set different materiality thresholds for different company sizes and procedural safeguards.[76] This approach has proven effective in jurisdictions like the UK, where FCA Listing Rule 11 only applies to transactions when one of the ratios resulting from the application of class tests[77] is greater than 0.25 percent.[78] However, by not setting the quantitative ratios for the materiality threshold, the European legislation leaves the decision to Member States as to whether they want to enact a strict regulatory regime or merely a protection against the most substantive related-party transactions.[79] This option creates a lot of leeway for Member States and the most important choice in implementing the directive concerns the definition of “materiality.”[80]

Thirdly, material transactions must be publicly announced by the time of their conclusion, with the announcement containing all relevant information to enable outside shareholders to decide whether the transaction is on fair and reasonable terms.[81]

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[74] *See* for instance International Accounting Standard [IAS] 24(9).
[75] *Infra* notes 86 and accompanying text.
[76] Shareholder Rights Directive (EU) 2017/828 of 17 May 2017 prec, art. 9c (6).
[77] FCA HANDBOOK, LR 10 ANNEX 1, www.handbook.fca.org.uk/handbook/LR/10/Annex1.html#D256.
[78] *See* LR 11.1.6 (1) and ¶ 1 of LR 11 Annex 1.
[79] By way of illustration, the Austrian implementation requires an approval by the supervisory only if it exceeds 5% of total assets, and a publication only of it exceeds 10%. Aktiengesetz [AktG] [Stock Corporation Act] March, 31, 1965, § 95a (Austria). This way most transactions will remain under the radar. Outside shareholders will never know about the transactions. In Germany, the threshold appears to be 1.5% of the sum of current and non-current assets. Aktiengesetz [AktG] [Stock Corporation Act], September, 6, 1965, §§ 111b-c (Ger.).
[80] Engert and Florstedt used data based on IAS 24 reporting of related party transactions to estimate the number of German companies affected by quantitative materiality thresholds based on accounting assets, sales, market capitalization, and other financials. They conclude that for effectiveness purposes multiple quantitative tests should be used to define material related party transactions. Andreas Engert & Tim Florstedt, *Which related party transactions should be subject to ex ante review? Evidence from Germany*, J. CORP. L. STUD.1 (2019).
[81] In contrast to the initial proposal by the Commission, Member States only *may* provide, but need not require, that a fairness report accompanies the announcement, see *supra* note 65.

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Fourthly, in addition to the disclosure provisions, material transactions must also be approved by the general meeting and/or the administrative or supervisory body of the company.[82] In principle, related parties are excluded from the approval process. However, Member States may allow related shareholders to take part if they are not able to outvote the majority of outside shareholders or independent directors. To take an example, in a case where related shareholders hold 60 percent of the voting rights, they may be entitled to vote in the general meeting if the majority threshold is at least 80 percent.

The approval procedure has been a very controversial aspect in the legislative process, since the Commission initially wanted to provide for a mandatory vote by the general meeting as in the FCA's Listing Rule 11.[83] However, such vote would have been detrimental to the existing regulatory frameworks in many continental European countries, which are far more board-centered than in the United Kingdom. The alternative board approval mechanism currently provided is, however, a weak safeguard: By not excluding representatives of the related party from the voting process, the EU relies on the Member States to set procedures which "prevent a related party from taking advantage of its position."[84] In this regard, the directive is unnecessarily vague, creating the potential circumvention of its intended restriction of the voting power of related parties.

Fifthly, transactions in the ordinary course of business which are concluded on normal market terms are excluded from the directive's requirements. The administrative or supervisory body of the company is only obliged to establish a periodic assessment of their customariness and fairness.[85] In addition to this important exemption, Member States are given the option of excluding or allowing companies to exclude several types of transactions.[86]

The paragraph lists a variety of transactions that are unlikely to be used as a means of misappropriation, such as those for which national law already requires shareholder approval, which are already regulated by the say-on-pay provision in the SRD, or which are offered to all shareholders on the same terms.[87]

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[82] *Supra* note 36, art. 9 ¶ 4.
[83] FCA HANDBOOK LR 11.1, www.handbook.fca.org.uk/handbook/LR/11/1.html.
[84] Shareholder Rights Directive (EU) 2017/828 of 17 May 2017, Amending Directive 2007/36/EC, art. 9 ¶ 2.
[85] *Id.* at art 9c ¶ 5.
[86] *Id.* at art. 9c ¶ 4.
[87] *Id.* at art. 9a.

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It is worth noting that there is no exemption for corporate groups.[88] Instead, only transactions with subsidiaries that are wholly-owned, in which no other related party has an interest or when national law provides for adequate alternative protection, may be excluded. The new regime, therefore, fully applies to transactions between listed subsidiaries and their parent company.[89]

1.2.2 Tensions between civil law traditions and EU requirements

Enforcement conditions the effectiveness of RPT rules – but access to information is, in turn, one of the key conditions of the enforcement of the rules. It is, however, a weak point in many European jurisdictions. Typically, enforcement has remained exceedingly rare in Germany, not least because shareholders cannot access the audited "dependency report" on intra-group dealings.[90]

Beyond that, the evolution of self-dealing transactions law at the European level reflects a deep change in European corporate culture. The foundation of a more modern corporate culture in most Member States can be traced back to the numerous green and white papers that were published in the early 2000s, following the string of corporate scandals: Enron, WorldCom, Parmalat, etc.[91] Under the pressure of international scrutiny exemplified by the World Bank Group's *Doing Business* reports and OECD reviews, as well as structural evolutions such as the feminization and internationalization of boards, the increasing number of independent directors,[92] and the growing role of proxy advisors and activist bodies,[93] continental European corporate governance is progressively breaking free from the deeply entrenched "club" culture

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[88] Though many German scholars and practitioners, used to specific corporate law provisions applicable to corporate groups, called for one: *see, e.g.*, *Common position of the Bundesverband der Deutschen Industrie and Deutsches Aktieninstitut*, (Nov. 12, 2015), www.dai.de/files/dai_usercontent/dokumente/positionspapiere/2015-11-12%20SHRD-Position%20BDI%20und%20DAI.pdf.

[89] This is true, even if there is an alternative system of compensation. *See, e.g.*, Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, § 291-307 (Ger.). the German Enterprise Agreement.

[90] Tobias Tröger, *Germany's Reluctance to Regulate Related Party Transactions in France. A Industrial Organization Perspective*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 426 (Luca Enriques & Tobias Tröger, eds., 2019).

[91] See for example, in France, Daniel Bouton, Report on Better Governance in Listed Companies (2002) available at www.paris-europlace.net/files/a_09-23-02_rapport-bouton.pdf.

[92] For recent figures on the composition of listed companies' board, see HIGH COMMITTEE FOR CORPORATE GOVERNANCE ANNUAL REPORT, HAUT COMITÉ DE GOUVERNEMENT D'ENTREPRISE, 37–47 (2017), https://hcge.fr/wp-content/uploads/2018/01/Rapport_annuel_Haut_Comite_EN_201710.pdf.

[93] See European Securities and Market Authorities (ESMA), *An Overview of the Proxy Advisory Industry* (2012) (Discussion paper), available at www.esma.europa.eu/document/discussion-paper-overview-proxy-advisory-industry-considerations-possible-policy-options.

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that once characterized the top management of many companies in Italy, Germany, France, and most other jurisdictions in continental Europe. Their corporate governance is as a result, becoming more professional. In particular, conflicts of interest and tunneling have now been recognized as issues that must be addressed, as the European Commission's intervention demonstrates.

Nevertheless, there is a risk that harmonized EU related party law may still promise more than it can deliver for three main reasons. First, continental European jurisdictions have so far made relatively little use of the "trusteeship" strategy.[94] The importance of independent third parties remains limited: involvement of independent experts, independent board members, and a more active role of auditors would directly improve the effectiveness of RPT law. Skepticism towards independent third parties may reflect a remaining trace of the traditional "club" culture in business.

Secondly, the scope of the law lacks clarity. In particular, EU regulations use the expressions of "indirect interest" without defining them or providing guidance as to their limits. As a consequence, parties err on the side of error, which is not efficient.

Thirdly, as most requirements introduced by the EU directive are already included in the rules applicable in France and Italy,[95] assessment of the effectiveness of self-dealing rules in these jurisdictions is relevant. It can be noted that, there, advocates of shareholders' rights argue that the law is often ineffective to prevent abuse for want of effective reporting systems and enforcement.[96] Meanwhile, business associations argue in favor of less burdensome reporting requirements, for instance requesting a materiality threshold.[97] In France, the recently introduced requirement that the board must not only vote, but must justify its vote,[98] has the potential to improve the quality of decision-making, as well as increasing transparency for shareholders, and facilitating enforcement against the board.

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[94] John Armour, Henry Hansmann, & Reiner Kraakman, *Agency Problems and Legal Strategies* in ANATOMY, *supra* note 12, at 2, 35.

[95] *See* Helleringer, *supra* note 40; Bianchi, Enriques & Milic, *supra* note 25.

[96] *See* Helleringer, *supra* note 40 at 418–21.

[97] For an article discussing the ambivalent assessments of the regulation in place, see Pierre-Henri Conac, *Related Party Transactions in French Company Law*, REVUE TRIMESTRIELLE DE DROIT FINANCIER no.3 26 (2014).

[98] Act n° 2019-486, May 22, 2019 on Corporate Growth and Transformation (*Loi relative à la croissance et la transformation des entreprises)*, art. 198.

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2. DIRECTORS' ENTREPRENEURIAL ACTIVITY OUTSIDE THE BOUNDARIES OF THE CORPORATION: CORPORATE OPPORTUNITIES AND THE DIRECTORS' DUTY NOT TO COMPETE WITH THE CORPORATION

Corporate directors' entrepreneurial skills and business networks may enable them to pursue profitable investments outside the boundaries of their corporation. Directors' personal business activities may conflict with the economic interests of the corporation whose success they are committed to pursue.[99] The richer an economic environment is in terms of new investment opportunities, the more directors may be tempted to divert their attention outside the boundaries of the corporation. Hence, it is unsurprising that corporate opportunity rules have been at the core of US corporate law since the end of the nineteenth century, when the US economy became the largest in the world.[100]

Today, two models address this issue in theory and practice.[101] The first is the corporate opportunity rules or doctrines, which is a set of rules strongly rooted in common law traditions.[102] The second is the directors' duty not to compete with the corporation, which originated in civil law systems.[103] Both models have been subjects to legal transplant. Corporate opportunity rules were introduced by means of legal reforms[104] or judicial interpretation[105] in

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[99] *See, e.g.*, Companies Act 2006, § 172 (UK).

[100] DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW (2018).

[101] For an in-depth comparison between these two models in the light of the theory of the firm, see Marco Claudio Corradi, *Corporate Opportunities Doctrines Tested in the Light of the Theory of the Firm – A European (and US) Comparative Perspective*, 27 EUR. BUS. L. REV. 755, 782–819 (2016).

[102] The Delaware seminal case is Guth v. Loft Inc., 5 A.2d 503 (Del. Ch. 1939). US Courts had already developed a corporate opportunity doctrine in the second half of nineteenth century. See the line of "connected assets" cases decided by New York courts, Murray v. Vanderbilt, 39 Barb. 140 (1863); Blake v. Buffalo Creek R.R. Co., 11 Sickels 485 (1874); Averill v. Barber, 53 Hun. 636 (1889); Robinson v. Jewett, 22 N.E. 224 (1889). An explanation of the rationale underlying this line of cases is offered by Kershaw, *supra* note 53, at 430–35. The UK seminal cases are R. v. Gulliver [1942] UKHL 1 and Boardman v. Phipps [1966] UKHL 2.

[103] In France, such duty has been mostly intended as referring to *concurrence déloyale*. *See, e.g.*, Cour de cassation [Cass.] [supreme court for judicial matters] com., Feb. 24, 1998, Bull. Joly 1998, 813. In Germany this rule is known as *Wettbewerbsverbot* and is regulated by *Aktiengesetz* (German Stock Corporation Act). *Supra* note 79, ¶ 88. *Codice Civile* (Italian Civil Code) contains rules on directors' *divieto di concorrenza* (duty not to compete) with the company. CODICE CIVILE [C.C.] art. 2390. Unlike the self-dealing rule – which pre-dates the Italian Civil Code (see *supra* note 66) – the duty not to compete was introduced in Italian law only with the 1942 unification of the Civil and Commercial Codes.

[104] The 5th section of Article 2391 of Codice Civile – on business opportunities – was introduced with Dlgs. 6/2003. *Gazzetta Ufficiale* n. 17 del 22 gennaio 2003 - Supplemento Ordinario n. 8.

[105] Seminal French corporate opportunities cases are Cass. 1e civ., Dec. 1, 2010, Bull. civ. I, No. 248; Cass. com., Dec. 18, 2012, Rev Soc 2013, 262. The foundational German case is Bundesgerichtshof [BGH] [Mo. Date] 1977, 361.

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most civil law jurisdictions.[106] Such introductions occurred gradually, after national courts had acknowledged in some form the existence of corporate directors' fiduciary duties, inspired by the way they are conceived in Anglo-American jurisdictions.[107] The directors' duty not to compete was in turn adopted only within US case-law.[108] By contrast, in the UK legal system, the existence of a directors' duty not to compete – separate from the UK corporate opportunity doctrines - has not yet been acknowledged.[109]

Despite their different denominations, the core economic function played by these two sets of rules are similar, albeit not identical. Both types of rules prevent insiders from expropriating private benefits of control from the corporation.[110] The main differences between them can be identified with reference to the corresponding legal framework adopted to target such expropriation. Corporate opportunity rules are often embedded in a proprietary framework. In fact, the protection of business opportunities is granted to the extent that they are "corporate" – that is, they belong to the corporation.[111] By contrast, the directors' duty not to compete with the corporation is a legal provision that focuses on the external economic activity carried out by directors – which must be in competition with the corporation.[112] Hence, directors' non-compete rules do not completely overlap with corporate opportunity rules. Some corporate opportunities

[106] Whether this was a successful transplant is debatable. For an in-depth analysis, see Martin Gelter & Geneviève Helleringer, *Opportunity Makes a Thief: Corporate Opportunities as Legal Transplant and Convergence in Corporate Law,* 15 BERKELEY BUS. L.J. 92 (2018).

[107] For France, see Cass. com., Feb. 27, 1996, JCP E. 1996, II, 838; Cass. com, 24 February 1998, Bull Joly 1998, 813; Cass. com., May 12, 2004, Rev. Soc. 2005, 140. For Italy, see Corte di cassazione [Cass.] [court of last appeal on issues of law in civil and criminal matters] Foro it. I, Aug. 24, 2004, No. 16707, 1844f. Such transplant has not been unproblematic from a theoretical perspective. See Fleischer, *supra* note 5.

[108] US case law acknowledges the existence of directors' duty not to compete with the corporation as a consequence of a misappropriation of a corporate opportunity (e.g., Burg v. Horn 380 F.2d 897 (2d Cir. 1967)) and as a cause of misappropriation of a corporate opportunity (e.g. Abbott Redmont Thinlite Corp. v. Redmont, 475 F.2d 85, 88 (2d Cir. 1973)). It also refers to directors' duty not to compete as a fiduciary duty that is clearly independent from the corporate opportunity doctrine. *See* Foley v. D'Agostino 21 A.D.2d 60 (1964). Finally, there are interpretations of the directors' duty not to compete with the corporation that seem to show a rationale inspired to unfair competition law. *See* Red Top Cab Co. v. Hanchett, 48 F.2d 236 (N.D. Cal. 1931). For an in-depth analysis of the relationships between US corporate opportunity rules and directors' duty not to compete, see Jodi L. Popofsky, *Corporate Opportunity and Corporate Competition: A Double-Barreled Theory of Fiduciary Liability,* 10 HOFSTRA L. REV. 1193 (1982).

[109] London & Mashonaland Exploration Co. v New Mashonaland Exploration Co., [1891] WN 165. *See also* Plus Group Ltd. v Pyke [2002] EWCA (Civ) 370.

[110] Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1043 (2011); Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004).

[111] Michael J. Whincop, *Painting the Corporate Cathedral: The Protection of Entitlements in Corporate Law*, 19 OXFORD J. L. STUD. 19 (1999).

[112] For a comparison between the two sets of rules, see Corradi, *supra* note 101.

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may be taken which do not entail setting up a competing activity with the corporation, and vice versa.[113]

US constituent states are the jurisdictions where corporate opportunity rules are most often invoked before courts.[114] Although US corporate opportunity doctrines can be traced back to the nineteenth century,[115] *Guth v. Loft* is considered the seminal Delaware case because it introduced the renowned "line of business test."[116] According to this test, only investment opportunities deemed as being in the line of business of the corporation are considered as corporate. The test is based on a "no-conflict" paradigm, showing no per se concern for the enrichment of a corporate director through their economic activity outside the boundaries of the corporation – provided that such activity causes no harm to the corporation.[117] US courts have also produced alternative corporate opportunity tests, such as the fairness test[118] or the so-called "mixed tests."[119] Nonetheless, such tests did not prevail over the *Guth v. Loft* doctrine in Delaware corporate law.[120] In fact, the Delaware Supreme Court confirmed the "line of business test" in *Bros v. Cellular Information Systems*.[121] Such an approach strikes a convenient balance in the trade-off between directors' freedom of enterprise and their loyalty to the corporation – although US legal scholars have advocated for a stricter approach.[122] This relatively lenient approach is based on the idea that many valuable and business-skilled individuals may be discouraged from taking up

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[113] *See* Popofsky, *supra* note 108, at 1194–96.

[114] A quick look to the oldest and newest US corporate opportunity cases shows that they have been decided across a vast spectrum of US constituent states. *See* Lagarde v Anniston Lime & Stone Co., 28 So. 199, 201 (Ala.1900); Lindenhurst Drugs, Inc. v. Becker*,* 506 N.E.2d 645 (Ill. App. Ct. 1987); Rapistan Corp. v. Michaels, 511 N.W.2d 918 (Mich. Ct. App. 1994).

[115] *See* Guth v. Loft Inc., 5 A.2d 503 (Del. Ch. 1939).

[116] *Id.* at 238–40.

[117] KERSHAW, *supra* note 100.

[118] Durfee v. Durfee & Canning, Inc., 80 N.E.2d 522 (1948).

[119] Miller v. Miller, 222 N.W.2d 71 (1974). For the unclear relationships among the cited tests, see Eric G. Orlinsky*, Corporate Opportunity Doctrine and Interested Director Transactions: A Framework for Analysis in an Attempt to Restore Predictability,* 24 DEL. J. CORP. L. 451 (1999).

[120] It has been suggested that also the Delaware Chancery has supported the fairness test in the past. See Johnston v. Greene, 121 A.2d 919, 922 (Del. Ch. 1956); Edward Welch et al., FOLK ON DELAWARE GENERAL CORPORATION LAW: FUNDAMENTALS 292–93 (2014).

[121] Broz v. Cellular Info Sys., Inc., 673 A.2d 148 (1996).

[122] Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities,* 94 HARV. L. REV. 997, 999 (1981); the authors are convinced that directors' overt compensation should be enough to incentivize their pro-corporate behaviors, without need to revert to covert compensation. The more general divergence between Delaware's interpretation of directors' fiduciary duties and the positions adopted by American academia is stressed by David Charny, *Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the Race to the Bottom in the European Communities,* 32 HARV. INT'L. L.J. 423, 447 (1991).

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directorships if they are totally prevented from exercising their freedom of enterprise outside the boundaries of the corporation.[123]

In the UK, where the corporate opportunity doctrine evolved in a way distinct from the US,[124] the prevailing doctrinal orientation still supports a no-profit approach, under which a director is not allowed to make any unauthorized profit out of the exploitation of a corporate opportunity - even when this would cause no harm to the corporation.[125] Such a rigid approach clearly shows that the phylogenetic connection to the law of trust[126] – from which corporate directors' duties originate as a distinctive set of rules[127] – is still extremely pervasive in the UK legal system.[128] It is also worth recalling that the UK corporate law model has been extremely influential worldwide. It has shaped the legal treatment of corporate opportunities across the Commonwealth jurisdictions,[129] including some of the most economically developed Asian economic areas, such as Hong Kong[130] and Singapore.[131] The UK's rigid approach has been heavily criticized.[132] In fact – especially when combined with the very effective UK remedial system – it may discourage directors from exploiting business opportunities even when their external business activities may produce positive welfare effects, while in no way harming the corporation.[133] At present, the only safe way for UK directors to pursue external business opportunities is by obtaining an authorization or a ratification from a majority of non-conflicted directors or from the shareholders' assembly.[134]

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[123] Richard Ramsey, *Director's power to compete with his corporation,* 18 IND. L.J. 293 (1942).
[124] Gelter & Helleringer, *supra* note 106, at 118–26.
[125] Companies Act 2006, § 175(4) (UK) ("[t]he duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.") This might be interpreted as an opening to potential no-conflict based interpretations. Nonetheless, even from recent case law, it is clear that UK courts are decided to stick to the no-profit paradigm as enunciated in R. v. Gulliver [1942] UKHL 1. *See, e.g.*, Bhullar v. Bhullar [2003] EWCA (Civ) 424 (Eng.).
[126] Keech v. Sandford [1726] EWHC Ch J76.
[127] Sealy, *supra* note 1. In US corporate law as well, it has been clear throughout the whole XX century that directors are not agents nor trustees of the corporation. *See* Warner Fuller, *Restrictions Imposed by the Directorship Status on the Personal Business Activities of Directors,* 26 WASH. U. L.Q. 189 (1940).
[128] Kershaw, *supra* note 53, at 439–40.
[129] For Canada, see Canadian Aero Services Ltd. v. O'Malley [1973] 40 D.L.R. (3d) 371 (Can.). For Australia, see Paul A Davies (Aust) Pty Limited v. Davies [1983] 1 NSWLR 440 (Austl.). For New Zealand, see Pacifica Shipping Co. Ltd. v. Anderson [1985] 2 N.Z.C.L.C (N.Z.).
[130] See for instance the recent case Poon Ka Man Jason v. Cheng Wai Tao [2016] 19 HKCFAR 144 (HK.).
[131] Tokuhon (Pte) Ltd. v. Seow Kang Hong [2003] SGHC 65 (Sing.).
[132] *See* David Kershaw, *Does It Matter How the Law Thinks about Corporate Opportunities*, 25 LEGAL STUD. 533 (2005).
[133] *Id.*
[134] *See* Companies Act 1985, §§ 85, 94 (on the exclusion of the conflicted director).

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Nonetheless, such procedures may stifle directors' will to swiftly pursue external business opportunities which in no way damage the corporation, given the uncertainty as to their capacity to appropriate the fruits of their efforts.[135] As noted by Klaus Hopt, a legally different but economically similar economic problem of inefficient regulatory rigidity may arise in the case of a resigned director willing to join a business offer by a third party in the field of business in which the corporation he used to work for is active.[136] In a similar case, the BGH, the German Supreme Court, has rejected an economically efficient approach proposed by the Court of Appeals of Stuttgart, which had allowed the resigned director to take the opportunity.[137] When such a rigid approach is adopted, "[d]irectors who have expertise, but not enough capital of their own, are prevented from opening their own business which is negative for themselves and the market as a whole."[138]

Another remarkable trait of the UK corporate opportunity law is its overreaching application. As a way to prevent strategic resignation, the UK corporate opportunity doctrine also applies to resigning directors.[139] Moreover – and more importantly – unlike in Delaware law,[140] not only business opportunities which the director has come to know about in their capacity as a director are deemed corporate. Any business opportunity, including those that the director may have acquired in their private life, are considered as belonging to the corporation.[141] This is a unique trait of UK (and Commonwealth) corporate opportunity doctrines. In fact, most civil law jurisdictions have made it clear that only those corporate opportunities that are acquired by the director while discharging their duties are considered corporate.[142] Finally, in UK law, the financial inability of the corporation to exploit a business opportunity does not excuse directors

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[135] This depends on the profit tracing system which characterizes the common law corporate opportunity remedial system. *See* Marco Claudio Corradi, *Securing corporate opportunities in Europe – comparative notes on monetary remedies and on the potential evolution of the remedial system,* 18 J. CORP. L. STUD. 439, 449–52 (2018).

[136] Klaus J. Hopt, *Conflict of interest, secrecy and insider information of directors, A comparative analysis*, 10 EUR. COMPANY & FIN. L. REV. 167, 179 (2013).

[137] BGH Sept. 23 1985, 1443 (Ger.).

[138] *Id.*

[139] Foster Bryant Surveying Ltd v. Bryant, [2007] EWCA (Civ) 200 (Eng.).

[140] Guth v. Loft Inc., 5 A.2d 503 (Del. Ch. 1939).

[141] Bhullar v. Bhullar [2003] EWCA (Civ) 424 (Eng.).

[142] For instance, the Italian civil code, refers to corporate opportunities of which directors became aware "became aware of in the exercise of their duties." C.c. art. 2391(5).

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in the event of misappropriations.[143] This is another notable feature of rigidity which distinguishes UK law from US law.[144]

Civil law jurisdictions such as France, Germany and Italy have applied a duty not to compete with the corporation since the mid-nineteenth century.[145] The transplant of corporate opportunities has taken place at different times within different European jurisdictions. In West Germany, academics have been developing a corporate opportunity doctrine inspired by US law (*Geschäftschancenlehre*) since the 1950s.[146] Such a doctrine was then introduced by the German Supreme Court at the end of the 1970s.[147] In France, a corporate opportunity doctrine has been elaborated progressively and rather cautiously by courts in more recent times,[148] while the Italian civil code corporate opportunity rule has never been applied by Italian courts. Given the limited number of cases that have been brought to the attention of civil law courts, the interpretation of such rules may still be considered a work-in-process.[149]

The main reason why corporate opportunity rules are not frequently the subject of disputes in continental Europe might be traced to the rather ineffective remedial systems by which they are assisted in those countries. In fact, the main civil law remedy applied against misappropriations is usually damages.[150] Damages are rather difficult to calculate, given the uncertainty that surrounds the potential success of a given investment opportunity.[151] This is why, where alternative rules (such as the duty not to compete with the corporation) are assisted by more effective remedies, such rules may turn out to be more advantageous to the corporation. For instance, this is the case for the German *Wettbewerbsverbot*, which is assisted by an

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[143] R. v. Gulliver [1942] UKHL 1.
[144] *Cfr.* Broz v. Cellular Info Sys., Inc., 673 A.2d 148 (1996).
[145] *See supra* note 103.
[146] ERNST MESTMÄCKER, VERWALTUNG, KONZERNGEWALT UND RECHTE DER AKTIONÄRE 166 (Müller 1958).
[147] BGH [Mo. Day, 1977], 361 (Ger.)
[148] See the French case law cited *supra* note 105.
[149] This is acknowledged by national legal jurisprudence. For an explanation of the state of the art in French law, see Geneviève Helleringer, *Le dirigeant à l'épreuve des opportunités d'affaires*, 24 ETUDES ET COMMENTAIRES-CHRONIQUES RECUEIL DALLOZ 1560 (2012). For the interpretative difficulties still found in Italian law, see Marco Claudio Corradi, *Le opportunità di affari all'ultimo comma dell'art. 2391 cc: profili interpretativi tra "società" ed "impresa"*, 38 GIURISPRUDENZA COMMERCIALE 597, 597–98 (2011). For several hermeneutical problems still debated in German law, see Holger Fleischer, *Gelöste und Ungelöste Probleme der Gesellschaftsrechtlichen Geschäftschancenlehre*, 21 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 985 (2003).
[150] For France, see Thibaut Massart, *Note to Cass com 18 December 2012*, 2013 REV. SOC. 262, 266. For Germany, see AKTIENGESETZ KOMMENTAR § 88, ¶ 33, Rz. 2 (3rd ed., Karsten Schmidt & Marcus Lutter 2015). For Italy, see Marco Ventoruzzo, *Commento all'Articolo 2391 del Codice Civile*, *in* COMMENTARIO ALLA RIFORMA DELLE SOCIETÀ 490–99 (Piergaetano Marchetti et al., eds., 2006).
[151] *See* Ventoruzzo, *id*., at 499.

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Eintrittsrecht (a subrogation right), a remedy whose effects are very similar to the US' disgorgement of profits or the UK's account of profits.[152]

Nonetheless, it may be worth recalling that even the most cogent civil law remedies cannot easily replicate the deterrence effects attached to an account of profits assisted by a constructive trust (i.e. the ordinary equity remedy applied by Anglo-American courts). An account of profits allows for profit tracing. The plaintiff is therefore able to retrieve all of the subsequent reinvestments of the proceeds of a misappropriation of corporate opportunities.[153]

Such a remedy may have an intrinsic psychological deterrence effect, due to its long-term reach. A director who has misappropriated a corporate opportunity may be asked to disgorge their profits to the corporation. This is regardless of the steps the director has undertaken to create legal distance from the original asset, through subsequent sales and purchases.[154] Another point of strength of the Anglo-American system is represented by the fact that, when this proves more effective, the plaintiff can also claim damages in the form of equitable compensation[155] or common law damages.[156] This may turn out to be easier in cases where it is clear that the same corporate opportunity would have been exploited far more profitably by the corporation.[157]

The cogency of Anglo-American corporate opportunity remedies certainly represents a point of strength in relation to the original function of corporate opportunity rules – i.e. securing corporate fiduciaries' loyalty.[158] Nonetheless, the increasing importance of less traditional forms of financing, such as venture capital (VC),[159] has challenged the role of corporate opportunity rules – especially in highly innovative environments known as industrial clusters.[160]

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[152] See Gerald Spindler, in 2 MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ § 88, ¶¶ 32–38 (Wulf Goette & Mathias Habersack eds., 2019).

[153] *See, e.g.*, A-G for Hong Kong v. Reid, [1994] 1 AC 324 (UK).

[154] Corradi, *supra* note 135.

[155] *See* Joshua Getzler, *Equitable Compensation and the Regulation of Fiduciary Relationships*, *in* RESTITUTION AND EQUITY 235–57 (Peter Birks & Francis Rose eds., 2000).

[156] See DAVIES & WORTHINGTON, *supra* note 29, at ¶ 16–181.

[157] Jeff Berryman, *Equitable Compensation for Breach by Fact-Based Fiduciaries: Tentative Thoughts on Clarifying Remedial Goals*, 37 ALTA. L. REV. 95, 99 (1999).

[158] Sitkoff, *supra* note 110, at 1043.

[159] On venture capital in general, see Michael Gorman & William A. Sahlman, *What Do Venture Capitalists Do?*, 4 J. BUS. VENTURING 231 (1989).

[160] A vivid depiction of the thriving business environment of one of the most renowned industrial clusters, the Silicon Valley, is offered by ANNALEE SAXENIAN, REGIONAL ADVANTAGE. CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE, 128 (Harvard University Press 1996).

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VC funds often invest in competing start-ups.[161] As a way to support start-up development and as a means of controlling their investment, VC funds often appoint their general partners as directors in the board of the start-ups in which they invest.[162] As within each VC fund there is normally a limited number of general partners, the same general partner may sit on the board(s) of competing start-ups. Even when this does not occur, each general partner may easily communicate with their colleagues. Hence, VC fund-appointed directors may find themselves in a position of divided loyalty.[163] First, they may be unable to decide on which of their start-ups they should offer the same business opportunity to. In fact, corporate opportunity rules may require them to offer the same opportunity to all the start-ups in which they have invested, while at the same time excluding each competitor from communicating with each other. Second, entrepreneurs that have obtained VC backing may easily accuse general partners of misappropriating corporate opportunities even after the exit phase, as opportunities in the same line of business are likely to be exploited by competing start-ups.[164]

For the reasons mentioned above, the Delaware General Corporation Law (DGCL) was reformed in 2000, introducing § 122(7), which contains a new rule granting companies the possibility to introduce a corporate opportunity waiver. Empirical research shows that such waivers have been widely employed by Delaware corporations in recent years – even though Delaware courts have not yet had a chance to identify the limits within which such waivers may be formulated.[165] The overall impression one may have of the development of US Delaware law is a progressive flexibilization of the use of corporate opportunity rules, which may still retain their importance in the protection of several corporate investments without conflicting with modern financing strategies.[166]

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[161] Terence Woolf, *The Venture Capitalist's Corporate Opportunity Problem,* COLUM. BUS. L. REV. 473, 489 (2001).
[162] *Id.*
[163] *Id.*
[164] This is what occurred in a recent Delaware corporate opportunity case, Alarm.com Holdings, Inc. v. ABS Capital Partners, Inc., et al., C.A. No. 2017- 0583-JTL, at 1 (Del. Ch. June 15, 2018).
[165] Gabriel Rauterberg & Eric Talley, *supra* note 18.
[166] Other kinds of investors, such as angel investors, are increasingly organized in associations. This may pose corporate opportunity problems similar to those occurring in the venture capital industry. *See* Scott Shane, *Angel Groups: An Examination of the Angel Capital Association Survey*, Jan. 1, 2008, https://ssrn.com/abstract=1142645 or http://dx.doi.org/10.2139/ssrn.1142645. Differences in investment techniques still exist between venture capital and angel investment. *See* Dan Hsu et al., *What matters, matters differently: a conjoint analysis of the decision policies of angel and venture capital investors*, 16 VENTURE CAPITAL 1 (2014).

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The development of corporate opportunity rules in the sense of a progressive flexibilization and customization seems to represent a very lively trend in US corporate law. Meanwhile, European corporate laws seem to devote limited attention to this problem. Indeed, the possibility of a corporate opportunity waiver has not been expressly acknowledged yet in most European corporate laws – although it has been debated in German literature.[167] This limited attention to this specific problem mirrors the general underdevelopment of European corporate opportunity doctrines compared to the US alternatives. Nonetheless, it is clear that corporate opportunity rules are still very important in defending the boundaries of the corporation, while they also remain crucial with regard to VC investments. In fact, waivers are likely to be unilateral, while entrepreneurs who also sit on the board of directors of a start-up may find it difficult to obtain a waiver through VC funds. This is why more attention being paid by European legal scholars to this topic may enhance the chances of efficient legislation being introduced.

3. CONCLUSIONS

Self-dealing, RPTs, the taking of corporate opportunities and directors' competing activities are ways to extract private benefits of control from the corporation and can be read under the economic agency costs paradigm. Most of these rules have also been the object of legal reforms across a vast number of jurisdictions. Despite their similarities in function, the legal patterns emerging on a global scale allow us to identify several differences when comparing self-dealing and RPTs rules on one hand and corporate opportunity rules and directors' duty not to compete on the other.

First, self-dealing rules have existed in common and civil law jurisdictions under different denominations for a long time. By contrast, corporate opportunity rules have been introduced in civil law jurisdictions in the form of a legal transplant – being directors' duty not to compete with the corporation only a partial substitute for corporate opportunity rules. Hence, it is not surprising that the corpus of jurisprudence on self-dealing is far more developed than the one on corporate opportunities.

[167] Alexander Hellgardt, *Abdingbarkeit der gesellschaftsrechtlichen Treuepflicht*, *in* UNTERNEHMEN, MARKT UND VERANTWORTUNG: FESTSCHRIFT FÜR KLAUS J. HOPT ZUM 70. GEBURTSTAG AM 24. AUGUST 2010 765–94 (2010).

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Second, unlike corporate opportunity and non-compete rules, requirements relating to self-dealing and RPTs are at the core of the law of listed corporations and, after the 2007–08 scandals, have emerged as part of the corpus of post-crisis, “modern” corporate law – across the globe. They are now periodically disclosed to the public in most jurisdictions and therefore are easily observable also by the common layman. By contrast, corporate opportunity doctrines are still a “matter for specialists,” especially in Europe: Although corporate opportunities are in fact an important component of modern corporate culture in the US, namely in the VC sector, in Europe they are rarely recalled in the corporate law debate.

One of the possible reasons may be the focus of a large part of legal scholars and innovative corporate lawyers on listed corporations. In addition – although misappropriations of corporate opportunities probably occur daily worldwide – only the US has produced a vast series of legal precedents on this subject matter. Hence, the interpretation of such rules is still uncertain for legal practitioners in most jurisdictions. Moreover, and in contrast to RPTs rules, there is no common EU legislation in this area of the law. This absence of harmonization may be justified not only in terms of scarce interest by the EU legislator, but also as a consequence of the strong divergences in terms of corporate opportunity doctrines across EU jurisdictions, where the UK one represents the most peculiar and divergent model.

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