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Directors' Duty of Loyalty

Corporate Opportunity Rules as Restrictions of Competition

Marco Corradi and Julian Nowag

8.1 INTRODUCTION

When a company's director encounters new business opportunities, a question arises whether they can privately exploit such opportunities or whether such opportunities 'belong' to the cooperation. This question is the core issue addressed by corporate opportunity rules in different corporate law systems around the world. This chapter explores how corporate opportunity rules may restrict competition and proposes that further evidence on the effects of such restrictions should be collected. The chapter starts out by setting out the origins and the basic principles of corporate opportunity rules and how their fiduciary origin aims to prevent insiders from becoming competitors. The chapter provides a general account of how these rules might potentially compete focusing on unilateral effects and examines in more detail possible negative effects on dynamic efficiencies. It highlights the importance of collecting further evidence to better understand this complex phenomenon.

8.2 WHAT ARE CORPORATE OPPORTUNITY RULES

Instances of protection of a collective business from the misappropriations of material or immaterial assets by insiders have been around for millennia. Roman imperial Rescripta and medieval gilds' organisational rules already reflected the tension between the necessity to keep assets and trade secrets within the boundaries of the association on the one hand and the attempt to protect the freedom of enterprise of the individual associate on the other.[1] In the modern corporation, these rules are a manifestation of the directors'[2] duty of loyalty.[3] Hence, they are deemed as

This chapter is based on previous work by the authors and presents the core of the paper 'Enforcing Corporate Opportunities Rules: Antitrust Risks and Antitrust Failures' forthcoming 2023 European Business Law Review.

[1] M Corradi, Corporate Opportunities: A Law and Economics Analysis (Hart 2021)

[2] Or other fiduciaries' duties.

[3] For the UK law, see P Davies and S Worthington (eds), *Gower and Davies' Principles of Modern Company Law* (9th edn, Sweet & Maxwell 2012), ch 16; in Spain, article 228 of the *Ley de Sociedades*

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being one of the core sets of rules that characterise modern corporate law. Besides their primary function of protecting the proprietary's boundaries of the corporation from misappropriations by insiders, corporate opportunity rules may also create monetary counterincentives to competition by directors with the corporation that employs them.

In modern times, corporate opportunity rules were first introduced in the Anglo-American jurisdictions and subsequently imported also into the German legal system.[4] Only since early 2000, they have become widespread in most civil law jurisdictions and at times they are included in national corporate governance codes.[5] Hence, any potential anticompetitive harm, both in terms of static as well as dynamic efficiency[6] deriving from the enforcement of corporate opportunity rules, might increase in future with any further expansion of these rules. Regardless of their future expansion through case law, their mere presence may strongly affect the allocation of many kinds of rights among economic actors *ex ante*. As we will argue in the following sections, the rules may consolidate the power of firms and discourage their insiders from attempting to enter the market.

The essence of these rules is the retention of the value and the fruits of business information within the corporation. Therefore, directors (and other insiders) have to disclose information on new business opportunities before any eventual company-authorised appropriation of corporate opportunities can take place.[7] An example of a sophisticated version of this kind of rule is point 4.3.1 of the German Corporate Governance Code, as amended in 2015: 'Members of the Management Board are bound by the interests of the company. When making their decisions they must not pursue any personal interests, are subject to a comprehensive prohibition to compete during their work for the company and must not exploit for themselves business opportunities to which the company is entitled'. If the corporation has not

de Capital identifies directors' obligations deriving directly from their duty of loyalty; The German Federal Court has also expressly reminded that corporate opportunities are a direct derivation of the duty of loyalty and not of the directors' duty not to compete with the corporation. See BGH 4.12.2012, II ZR 159/10, DStR 2013, 600 = NZG 2013. 216.

[4] In Germany, the *Bundesgerichtshof* introduced these rules through an extensive interpretation of the principle of loyalty of directors to the company (*die Trueupflicht*), and more specifically of their duty to avoid conflicts of interests (*das Gebot der Vermeidung von Interessenkonflikten*). See BGH WM 1977, 361, 362; BGH WM 1983, 498; BGH NJW 1986, 584, 585; BGH WM 1989, 1335, 1339. Corporate opportunity rules were discussed in a very thorough way before being introduced, thanks to an exemplary jurisprudential effort. Awareness of the problem was already revealed in EMestmäker, *Verwaltung, Konzerngewalt und Recht der Aktionare* (Müller 1958) 166ff. Further references to the first jurisprudential contribution to German corporate opportunity rules are found in M Löhnig, *Treuhand* (Mohr Siebeck 2006) 372, in particular n 2.

[5] See for instance the German Corporate Governance Code, Rule 4.3.1

[6] For details see Section 8.4.

[7] For comments see H Wilsing (ed), *Deutscher Corporate Governance Kodex Kommentar* (Verlag CH Beck 2012) para 4.3.3. [Treupflicht] 363, paras 12ff.

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authorised a given appropriation by a director, but the director still appropriates the business opportunity, the corporation can address the situation with the various remedies described in the following paragraphs.

For the analysis of this chapter, the following three specific aspects are particularly relevant and briefly discussed: (1) the industrial relevance of corporate opportunity rules; (2) the remedies that are available against a non-authorised appropriation of a corporate opportunity by a director or another insider; (3) the question of whether corporate opportunity rules are mandatory or not. Section 8.4 then builds upon these aspects and highlights their possible anticompetitive harm.

First, in terms of industrial relevance, corporate opportunity rules may cover a very wide set of cases. To provide an idea of the variety of the situations commonly discussed under the 'label' of corporate 'opportunity', consider the following. From an industrial perspective, a corporate opportunity can consist of the possibility to acquire the following assets: a trade secret, such as the Pepsi-Cola secret formula;[8] a cellular telephone service;[9] a mining licence[10] a specific piece of land;[11] technical equipment (at ordinary market price);[12] a business (cinema);[13] stock of the corporation by one of its directors from a third party, at a convenient value[14] or in the case of an initial public offering.[15] A corporate opportunity could also be the offer of a contract to be the developer of a given line of business on the behalf of a third party.[16]

Second, the remedies against misappropriation[17] can range from damages[18] to an action for unjust enrichment[19] or even, in certain jurisdictions, a disgorgement

8 *Guth* v *Loft* 5 A2d 503 (Del. 1939)

9 *Broz v Cellular Information Systems, Inc*. 673 A2d.

10 *Queensland Mines Ltd.* v *Hudson* (1978) AJLR 399 and *Peso Silver Mines (NPL)* v *Cropper* (1976) SCR 673 (Supreme Court of Canada).

11 *Bhullar* v *Bhullar* [2003] EWCA Civ 424

12 *American Metal Forming Corporation v W Pittman* 52 F3d 504; *Knox Glass Bottle Co v Underwood* 89 So 2d 799 (Miss. 1956)

13 *Regal (Hastings) v Gulliver* [1967] 2 AC 134

14 *Faraclas* v *City Vending Co* 194 A2d 298 (Md. 1963). But see an opposite view in *Weigel v Shapiro J W* 608 F2d 268. The question has been debated for a long time. On this point see Victor Brudney, 'Insider securities dealing during corporate crisis' (1962) 61 Mich L Rev 1–38.

15 *In re eBay Inc. Shareholders Litigation* 2004 WL 253521 (Del Ch 2004). *Canadian Aero Service Ltd* v *O'Malley* [1974] SCR 592 (Supreme Court of Canada).

16 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443.

17 For a comparative analysis of remedies against misappropriations of corporate opportunities, See M Corradi, 'Securing corporate opportunities in Europe–comparative notes on monetary remedies and on the potential evolution of the remedial system' (2018) 18 J CLS 439–473.

18 Damages in for of 'damnum emergens' or 'lucrum cessans' or both. See for instance Italian Civil Code, Article 2391 (5).

19 M Corradi, 'Securing Corporate Opportunities in Europe – Comparative Notes on Monetary Remedies and on their Potential Evolution' (2018) J CLS (forthcoming) offers a comparative analysis of this remedy within a sample of European jurisdictions.

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of profits,[20] eventually assisted by a constructive trust (in its personal or proprietary form).[21]

The essence of all corporate opportunity rules could, therefore, be described as the ability of the company to prevent an insider from appropriating part or all of the profits generated from the business opportunity. In other words, corporate opportunity rules may create monetary counterincentives to competition by insiders.

8.3 CORPORATE OPPORTUNITY RULES: A THEORY OF UNILATERAL EFFECTS

From an economic perspective, corporate opportunities can possibly be understood in light of the theory of the firm.[22] As a manifestation of directors' duty of loyalty to the corporation – along with self-dealing – they are one of the main corporate law rules that are functional to containing agency costs and therefore attract potential equity investors.[23] Moreover, in those jurisdictions where they are formulated according to the 'no-conflict' paradigm or where they include the 'line of business test', those rules can be understood as a way to protect what Oliver Williamson refers to as 'idiosyncratic investments'.[24] We, therefore, recognise that the enforcement of corporate opportunity rules has an economic justification. The rules' efficiency justification is based on law and finance considerations by majoritarian doctrine. This means that it is appropriate to protect corporate opportunities against misappropriations by insiders because such protection contains agency costs and stimulates investments in equity. In other words, corporate opportunity rules provide for a regime in which the company has the incentive to invest in insiders or the development of its business because any potential returns cannot be expropriated but are secured by those rules.

[20] Disgorgement of profits is the typical Anglo-American remedy that assists corporate opportunities misappropriations. For the UK, see for instance *Bhullar v Bhullar* [2003] EWCA Civ 424. The situation in US law differs from state to state, as corporate law is not federal. Nevertheless, the general remedy available in almost every US state corporate law is disgorgement of profit. See Eric Orlinsky, 'Corporate Opportunity Doctrine and Interested Director Transactions: A Framework for Analysis in an Attempt to Restore Predictability' (1999) 24 Del J Corp L 451. The only continental European law that assist misappropriations with a similar remedy is Spain. See Ley de Sociedades de Capital, art 227 (2): '[l]a infracción del deber de lealtad determinará no solo la obligación de indemnizar el daño causado al patrimonio social, sino también la de devolver a la sociedad el enriquecimiento injusto obtenido por el administrador'.

[21] At least in the UK it is now clear that in this case the constructive trust that applies is proprietary. This point is finally clear in the recent statements of Lord Neuberger in *FHR v Mankarious* [2014] UKSC 45 (paras 7 and 33).

[22] M Corradi, 'Corporate Opportunities Doctrines Tested in the Light of the Theory of the Firm – A European (and US) Comparative Perspective' (2016) 27 EBLR 755, for a detailed analysis of the rules in the light of the theory of the firm.

[23] Robert Sitkoff, 'The Economic Structure of Fiduciary Law' (2013) 91 BU L Rev 1039, 1043.

[24] Corradi (n 23) 771ff.

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Unfortunately, corporate insiders[25] may often be the most effective potential competitors for a company – especially in highly innovative environments. These individuals have acquired a solid knowledge of the market in which they have operated on behalf of their corporation, often for decades. Especially when they are directors or high-ranking officers, they are usually well aware of production processes, upstream and downstream markets, the relationship between fixed and marginal costs, and the state of the art with reference to innovation.[26] Not only are insiders well aware of market variables, but also of the specific business strategy of the firm they work for. Once they leave the corporation, the insiders' competitive advantage may enable them to act much faster as potential competitors than an outsider, pointing straight to the weaknesses of the corporation they have worked for.

Corporate opportunities, which are basically growth and development opportunities, can be the object of a negotiation between a company and its insiders.[27] But non-zero transaction costs might mean that such negotiations are inefficient.[28] If the rights to exploit a business opportunity are allocated to the already existing company, that company will tend to grow more easily. In the opposite case, that company's market power might be progressively eroded.[29] To a certain extent, corporate opportunity rules can also be compared to non-compete clauses.[30] Both provide the company with rights against agents working under its umbrella and both have developed from the idea of fiduciary duties towards the company. In this sense, both corporate opportunity rules and non-compete clauses or contracts can be seen as a way of containing hold-up costs. Both provide the company with incentives to invest in their staff/agents so that these individuals provide their principal – the company they work for – with a higher return. However, in contrast to corporate opportunity rules, many States are rather restrictive with regard to non-compete arrangements[31] or even prohibit such arrangements, for example as does California. Moreover, collusion between companies to the same end has attracted strong enforcement action

[25] Whether directors, officers, or controlling shareholders.

[26] And of all the other relevant variables in a business setting. See D Carlton and J Perloff, *Modern industrial organization* (Pearson 2015).

[27] See the models proposed by E Talley, 'Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunity Doctrine' (1998) 108 Yale LJ 277–375 and M Whincop, 'Painting the Corporate Cathedral: The Protection of Entitlements in Corporate Law' (1999) 19 OJLS 19–50.

[28] Corradi (n 23) 763ff.

[29] *Ibid*. at 770ff. See Section 8.4.

[30] For a functional law and economics analysis of the relationships between corporate opportunity rules and no compete clauses see M Corradi, 'Corporate Opportunity Doctrines Tested in the Light of the Theory of the Firm – a European (and US) Comparative Perspective' (2016) 27 Issue 6, EBLRev 755–819

[31] For a law and economics analysis of such agreements see, Office of Economic Policy U.S. Department of the Treasury, *Non-Compete Contracts: Economic Effects and Policy Implications* (March 2016) https://home.treasury.gov/system/files/226/Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf.

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by antitrust agencies, as the example of the non-poaching and wage-fixing agreements between Silicon Valley companies shows.[32]

To understand how the corporate opportunity doctrine may be employed strategically to create barriers to entry, one has to distinguish between at least two situations. First, the corporate opportunity doctrine may well be employed appositely to prevent an insider from becoming a direct competitor, on the horizontal plan. This is the most straightforward case. If an insider tries to set up a new company on the basis of business information they obtained during their time in the company, the company will simply ask the court to declare that the new company is held on constructive trust (with subsequent transfer order and/or disgorgement of profits) or ask for damages or for unjust enrichment, depending on the remedies available in the jurisdiction. Second, corporate opportunity rules may serve potentially anticompetitive investment strategies. Companies may revert to (side) strategies that entail operating in upstream or downstream markets. For example, this may happen when a given resource is indispensable for producing a given product at a certain stage of technological development.[33] An example of such strategic behaviour could be the taking of an opportunity to acquire relevant shares of an upstream market in raw materials that are necessary for the production process downstream. Through the enforcement of corporate opportunity rules, an incumbent company may prevent the insider from setting up a company that operates upstream.

Another related case of strategic use of corporate opportunities might be the possibility to secure the fidelity of distributors. As to contracts with distributors, such practice enables the company to recruit agents for retail operations. There may be different strategies that a company may adopt to try to monopolise downstream markets, when this is crucial for the success of the corporation (for instance, in the case of high-end fashion products). First, if an insider succeeds in setting up a new corporation in the same line of business as the company they work for, the original company may invalidate any newly signed contracts with distributors through the enforcement of corporate opportunity rules.[34] Second, if a director wants to set up

[32] District Court of Columbia (2011) *United States v Adobe Systems, Inc, Apple Inc, Google Inc, Intel Corporation, Intuit, Inc, and Pixar*, 1:10-cv-01629; District Court for the Northern District of California San Jose Division (2014) *United States v eBay, Inc* Case No 12-CV-05869-EJD-PSG, District Court Columbia (June 3, 2011) *United States v Lucasfilm Ltd* 1:10-cv-02220-RBW. See also, FTC and DoJ Antitrust 'Guidance for Human Resource Professionals' (October 2016) www.justice.gov/atr/file/903511/download accessed 5 March 2017.

[33] This phenomenon is usually known as 'vertical foreclosure' (upstream foreclosure in this case). See in general P Rey and J Tyrole, *Handbook of Industrial Organization* (Elsevier 2015) 2145–2220. On the issues of vertical foreclosure from a competition law perspective see G Bonanno and J Vickers, 'Vertical separation' (1988) 36 J Industrial Econ 257–265; D Carlton and M Waldman, 'The strategic use of tying to preserve and create market power in evolving industries' (2002) 33 Rand J Econ 194–220; Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C45/7, paras 18ff.

[34] In this case the actual line of business of the corporation.

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a company in the downstream market, the company again can proceed to vertical integration, claiming the new business through the enforcement of corporate opportunity rules.[35]

There may also be cases that are not related to horizontal competition or vertical integration but that would still be the taking of a corporate opportunity. These cases would usually arise under the 'potential line of business clause'. Examples are cases involving new commercial practices, such as the US tobacco case in 1940, where the idea was to launch lower quality cigarettes from lower quality blends of tobacco.[36] Although such commercial ideas may not be innovative in the classical sense, the commercial strategy adopted in this case shares many features of disruptive innovation, to which a significant part of Section 4(b) will be devoted.

There are at least two different categories of anticompetitive harm that may arise by way of the enforcement of a company's rights in relation to a corporate opportunity. The first category of anticompetitive harm derives from different types of foreclosure (for example, upstream or downstream foreclosure) which we have analysed in detail elsewhere.[37] The second category pertains to harm to the so-called dynamic competition.

8.4 POTENTIAL NEGATIVE EFFECTS ON DYNAMIC COMPETITION

One may be tempted to start the discussion on the competitive harm deriving from the enforcement of corporate opportunity way through the 'classic' static to a dynamic crescendo. But harm to the so-called dynamic competition[38] seems more significant in these cases and is therefore the focus of this chapter. When considering the enforcement of corporate opportunity rules and the effects on dynamic competition, the picture is rather complex, if not contradictory. This complex picture is not only the result of the different kinds of business opportunities[39] but also of the different types of dynamic effects.[40] A dynamic analysis can take place along the more traditional lines – innovation in connection with research and development (R&D) or the analysis can focus on disruptive innovation. Below we will examine both separately, adding to traditional considerations also more original ones, based on a disruptive innovation approach. In fact, companies are presented with both kinds

[35] Here in form of the potential line of business.

[36] See this case as reported by CS Hemphill and T Wu, 'Parallel Exclusion' (2012–2013) 122 Yale LJ 1182, 1201 and 1203. See also general references in Bishop and Walker, The Economics of EC Competition Law: Concepts, Application and Measurement (Sweet & Maxwell, 2010).

[37] See Corradi and Nowag (n 2).

[38] With all the caveats inherent to the use of this term, see V Kathuria 'A Conceptual Framework to Identify Dynamic Efficiency' (2015) 11(2–3) ECJ 319–339.

[39] See Sections 8.2 and 8.3.

[40] See Kathuria (n 39).

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of innovation. Finally, we will highlight some empirical studies that examine the effects of non-compete clauses on innovation because such clauses are similar to corporate opportunity rules in their effects.

The traditional dynamic competition analysis focuses largely on the relationships between IP rights and competition.[41] One of the core tenets of IP theory suggests a high degree of temporary protection for fruits of innovation derived from R&D.[42] Starting with these traditional dynamic efficiency considerations, corporate opportunity rules that attribute to the company the innovative business opportunities seem in line with several ideas grounded in the most established analysis of this type of competition *for* rather than *in* the market. First, in markets with high fixed costs and low marginal costs, IP rights are crucial. In fact, it is well known that R&D competition for certain kinds of patents is extremely fierce and that R&D is cost-intensive.[43] Second, in such markets, investment in R&D carries a very high risk, so the expected returns to the winner must be high. Third, there is an inherent tension between competition, that is competition for innovation on the one hand and monopoly power that is granted temporarily on inventions through IP rights on the other hand.

Business opportunities might take forms that can be protected by means of IP rights, for example, as patents. However, issues related to business opportunities may occur typically before questions about IP and competition arise. Similarly, corporate opportunity rules allow a company to appropriate the fruits of innovations that are not patentable, at least on a temporary basis. Therefore, the rules may be complementary to IP rights in their role of providing incentives for innovation, in particular, where the company has spent resources to support an insider's invention. Moreover, corporate opportunity rules seem less harmful in terms of competition than IP protection. IP rights are enforceable against everyone, while corporate opportunity rules only give rights to the insider. By contrast, here it could be said that the protection offered by corporate opportunities to innovation is in line with emerging doctrine on IP. Hovenkamp has described the evolution of IP rights as a shift from monopoly to property rights which is visible both in the IP and competition analysis.[44] Enforcement of corporate opportunity rules can be seen as an expression of a property right expressed through a constructive trust and a subsequent transfer order.

One might therefore argue that enforcing corporate opportunity rules is typically not detrimental from a traditional dynamic efficiency perspective.

41 See the traditional *Schumpeter v Arrow* debate.

42 On the economics of innovation see in general C Antonelli and others (eds), *New Frontiers in the Economics of Innovation and New Technology* (Edward Elgar 2006); G Silverberg and L Soete (eds), *The economics of growth and technical change* (Edward Elgar 1994); N Rosenberg and others (eds), *Technology and the Wealth of Nations* (Stanford UP 1992)

43 *Ibid.*

44 H Hovenkamp, 'Parents, Property, and Competition Policy' (2008) 34 J Corp L 1243.

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By contrast, certain cases of corporate opportunities may be more interesting from another dynamic efficiency, though so far less-explored perspective – disruptive innovation. Christensen's research on disruptive innovation has shown that innovation derives not necessarily from high expenditures in R&D.[45] Disruptive innovation usually consists of simplifications brought to an existing product, which has been over-refined by incumbent companies because of sustained innovation. Hence, certain consumers become progressively uninterested in the product because of over-sophistication. Moreover, the innovative simplifications introduced by the disruptive innovator usually are techniques that are not patentable. Quite often disruptive competition comes at a low cost, so there is no need to protect a company's financial R&D expenditure.

What does that mean for corporate opportunities cases? In such cases, the innovator is an insider. Therefore, the legal framework should provide incentives to innovate. Such incentives can certainly be generated by more liberal corporate opportunity rules, which allow the insider to take at least some corporate opportunities.[46] In this context, it should also be noted that strict corporate opportunity rules will lower insiders' incentives to undertake inventions in their free time. In other words, if an insider knows they cannot appropriate the fruit of their invention, there will be no incentive to spend time creating such innovations.

Furthermore, disruptive products tend to offer a set of attributes that is different from the ones offered in the mainstream market. While being innovative, disruptive products typically address a niche of the existing market and serve the low-end rather than the high-end market. Christensen provides many examples[47] where low-end innovation conquering a market completely in the medium-long term because incumbent firms were busy refining their old product. From the perspective of corporate opportunity rules, the question is therefore: what would an incumbent company do, knowing that disruptive innovation by means of low-end innovation, in which it is not presently interested, may become a potential foe? Such a company has, in effect, two options: it could develop the opportunity or it could appropriate it and kill it, thereby eliminating potential competition.

The first solution looks like the most efficient one, even from the point of view of a corporation. However, there are several potential drawbacks. First, it would be rather difficult to address all the possible innovations that could be developed by insiders. For example, if ten innovative opportunities arise in a given time, the incumbent company carefully analyses them all and decides that only one is potentially disruptive. Therefore, it uses all its resources for the development of that one

[45] See for instance J Bower and C Christensen, 'Disruptive Technologies: Catching the Wave' (1995) 73(1) *Harv Bus Rev* 43–53; C Christensen, *The Innovator's Dilemma* (Harper Business 2000); C Christensen and M Raynor, *The Innovator's Solution* (Harvard Business Review Press 2003); C Christensen, S Anthony and E*rik* Roth, *Seeing What's Next* (Harvard Business School Press 2004).

[46] If not by a corporate opportunities waiver.

[47] Many examples are provided in Christensen, *Innovator's Dilemma* (n 46).

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innovation. What will the company do with those innovative opportunities it has discarded? While benevolence towards insiders would suggest that these business opportunities may be left to the insiders to take, there is also another, more likely, option. Aware of disruptive innovation and of the limits to predicting accurately whether a given opportunity is disruptive or not, it is rational to appropriate and kill those opportunities that the company is not able or willing to pursue. Practically, the company would enforce the corporate opportunity rule on any kind of innovative opportunity even if it decides not to develop the opportunity and simply let it die. From the point of view of dynamic competition, such behaviour would be extremely harmful.

However, problems might arise even regarding those opportunities that the company appropriates to develop. In fact, the company may decide to use corporate opportunity rules to slow down innovation. In other words, the company may be slower than an insider in implementing innovation, because it is still able to earn from a previous technology without aiming to maximise the speed of innovation. Ezrachi and Stucke have shown this in relation to quality.[48] Another example is the already mentioned case of tobacco companies in the 1940s. If an insider had taken the opportunity and launched lower-quality cigarettes from lower-quality blends of tobacco, it may well have provided a springboard to later engage in competition with the 'normal' tobacco companies.

Finally, as we have explained above,[49] from the point of view of their economic function, corporate opportunity rules can be compared to non-compete clauses. The effects on innovation of such clauses also provide insights into the possible effects of corporate opportunity rules. There is some evidence that non-compete clauses have a negative effect.[50] Moreover, Gilson convincingly argued that the absence of non-compete clauses may be an incentive for Silicon Valley inventors. According to Gilson, the unenforceability of employee's non-compete covenants under Californian law[51] fosters intercompany knowledge spillovers, which are renowned as one of the main reasons for Silicon Valley's economic success over Route 128.[52] The impact of legal structure on innovation is confirmed by the likelihood of enforcement of the same kind of covenant under Massachusetts law and the lesser success of Route 128.[53]

[48] M Stucke, and A Ezrachi, 'When Competition Fails to Optimise Quality: A Look at Search Engines' (2016) 18 Yale J L & Tech 70 http://ssrn.com/abstract=2598128

[49] See text to (n 31–33).

[50] See for example the negative effects of non-compete and trade secrets, see C Graves and J DiBoise, 'Do Strict Trade Secret and Non-Competition Laws Obstruct Innovation' 1 (2006) *Entrepreneurial Bus LJ* 323–344; O Amir and O Lobel, 'Driving Performance: A Growth Theory of Noncompete Law' (2013) 16 Stan Techn L Rev 833–874.

[51] R Gilson, 'The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete' (1999) 74 NYUL Rev 575, 607ff.

[52] *Ibid*. at 620ff.

[53] *Ibid*. at 603ff.

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From a rational perspective, it seems rather surprising that companies would choose to be subject to Californian law that allows former employees to compete freely. One reason why they may choose to do so may be the sociological features of Silicon Valley, as Saxenien highlights. First, in Silicon Valley, loyalty to networks seems to prevail over loyalty to the company.[54] As a consequence, the boundaries between employers and employees are depicted as 'blurring'.[55] Second, despite the existence of a sort of network loyalty, competitive pressure is particularly strong, due to the demand for increasing innovation.[56] If Silicon Valley's success in terms of dynamic efficiency is related to the unenforceability of non-compete clauses, then one may have reason to question a strict and inflexible enforcement of corporate opportunity rules.[57]

The unenforceability of non-compete rules seems to highlight the close relationship between competition by insiders and dynamic innovation. Openness to a more flexible approach could be expected in the context of competition by insiders regulated by corporate opportunity rules: this is reflected in the introduction in Delaware corporate law of the possibility to approve an *ex ante* waiver for corporate opportunity rules. By contrast, such flexibility has not been reached yet by European corporate opportunity rules.[58]

8.5 OPEN QUESTIONS AND THE NEED FOR FURTHER EVIDENCE

Corporate opportunity rules are among a range of tools that can be employed to prevent insiders from competing with the corporation. As already mentioned, other examples may include for instance non-compete agreements and clauses. In this chapter, we have taken the first step in exploring new frameworks for the analysis of this multifaceted problem. And given the novelty of such a paradigm, it is not surprising that the framing of the competitive harm issue highlighted in this chapter proves difficult in the present competition law framework.

Having outlined the potential of corporate opportunities for significant effects on competition, static and dynamic considerations can be explored. Beyond the static concerns about exclusion on a horizontal level and about foreclosure on a vertical level, dynamic concerns seem far more pressing given the centrality of innovation in contemporary economic systems. Unfortunately, neither the current corporate nor competition rules can presently address these concerns sufficiently. Corporate opportunity rules are usually concerned with a containment of agency costs – although innovation dynamics have been considered in the last reform of

[54] A Saxenian, *Regional Advantage* (Harvard UP 1996) 36.
[55] *Ibid*. at 50.
[56] *Ibid*. at 46.
[57] Corradi (n 2) ch 5.
[58] *Ibid*. ch 7.

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Delaware corporate legislation.[59] In Europe, the absence of such flexibility calls for a strict enforcement of corporate opportunity rules, to defend investors' incentives to invest in equity. Thus, at least until the focus is on short-term investment returns, it is less surprising that corporate law does not address these concerns.

Indeed, even competition law is not able to provide sufficient tools to address the relevant competition concerns as we have explored elsewhere.[60] This has in particular to do with the *ex post* nature of the majority of competition laws. The classical tools of competition law, the cartel, and abuse/monopolisation rules are applied *ex post* and are ill-equipped to address dynamic and innovation concerns which are naturally forward-looking. The *ex ante* approach of the merger rules with its focus on future developments would seem better equipped to deal with the dynamic competition issues. Moreover, the comparison to a merger situation seems also closer to the situation at hand. In corporate opportunities cases, it is the future developments that are at issue. Seen from a competition perspective, the question is whether the enforcement of business opportunities would block a (future) competitor.

Elsewhere, we have suggested that a flexibilisation of corporate opportunity rules can help to address the competition problems stemming from such rules.[61] Crucial is further evidence resulting from cases, as it helps to inform policy discussion and helps in the design of any new corporate opportunity rules regime that takes account of potential negative effects on dynamic efficiency. Thus, future evidence-based research should explore whether the current corporate opportunity rules are in the majority of cases beneficial or harmful from a competition perspective with a special focus on dynamic efficiency. Ideally, such an examination would even go a step further and explore and categorise situations where corporate opportunity rules are more likely to be beneficial and those where this is not the case. For any such examination, the comparison to non-compete clauses might be fruitful comparison.

Case-based evidence should inspire the flexibilisation of standard rules and the relevant burden of proof. As establishing *ex ante* which kind of opportunity is beneficial to whom would often be a difficult operation, bargaining between the company and directors should play a crucial role – and corporate opportunity rules should inform such bargaining.[62] Keeping in mind the specific needs related to dynamic efficiency, one might explore whether the rules should allow the director faced with a claim to a corporate opportunity by the incumbent company to argue in its defence a potential harm to dynamic efficiency. In other words, while the standard rule could be that the opportunity remains with the company the director should then be entitled to abduct evidence that it would be more beneficial for dynamic efficiency if s/he were to receive the opportunity instead of the company. This adds

[59] See text to (n 24–26).
[60] See Corradi and Nowag (n 1).
[61] *Ibid*.
[62] Corradi (n 2) ch 4.

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a further potential variable to the already complex set of arguments that normally surround 'classic' corporate opportunity rule cases.

8.6 CONCLUSION

Since the Standard Oil saga, competition law has been characterised by periods of harsh enforcement and periods of milder 'wait and see' and in this sense it is described as having a highly political connotation when compared to for example corporate law.[63] Moreover, antitrust agencies are renowned for their periodical focus on specific sectors often requiring the full-time dedication of most of their staff. Therefore, it seems not surprising that a topic such as the one we have dealt with in this chapter has never attracted any attention of any enforcer at all. In this sense, the chapter is not only a call for the collection of more evidence on this topic. It is a starting point of a reflection about certain interactions between corporate and competition law rules, rather than a call for urgent action in this area. Yet, what might be in need of urgent and thorough rethinking are the core aspects of dynamic competition. Today, corporate founders and directors have become the carriers of sophisticated technological knowledge and insight. Rules that affect their freedom to develop their innovative ideas and potential definitely raise questions about potential harms to dynamic competition. And again, this area proves to be challenging and has so far escaped the traditional antitrust metrics inspired by structural analysis which is still based on the structure-conduct-performance paradigm with a focus on significant market shares. Overall, corporate law rules escape the present antitrust prohibitions, and the enforcement of these rules may prevent rare plants' seeds to sprout into Esperidis golden apple-bearing trees. In other words, the loss in innovation maybe not only be to the detriment of the inventors but also to consumers and society as a whole.

[63] W Kovacic, 'Politics and Partisanship in US Federal Antitrust Enforcement' (2013) 79 Antitrust LJ 687.

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