

BUSINESS OPPORTUNITIES AS A COMPANY ASSET

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I. WHAT IS THE CORPORATE OPPORTUNITY DOCTRINE?

A. The corporate opportunity doctrine is a well-recognized, common-law principle that one entrusted with the active management of a corporation, such as an officer or director, occupies a fiduciary relationship to the corporation and may not exploit his position as an ‘insider’ by appropriating to himself a business opportunity properly belonging to the corporation. Miller v. Miller, 222 N.W.2d 71, 78 (Minn.1974). The Minnesota Supreme Court has declared that the corporate opportunity doctrine is based on “fundamental rules of agency concerning the duty of utmost good faith and loyalty owed by a fiduciary to his principal.” Miller v. Miller, 222 N.W.2d 71, 78 (Minn. 1974). See also Triple Five of Minnesota, Inc. v. Simon, 404 F.3d 1088 (8th Cir. 2005); Foy v. Klapmeier, 992 F.2d 774 (8th Cir. 1993).

II. HOW DO YOU DETERMINE WHETHER LIABILITY EXISTS?

In Miller, the Supreme Court established a “two-step process” for determining when liability for usurpation of a corporate opportunity should be imposed.

A. The first step is to determine “whether a business opportunity presented is also a ‘corporate’ opportunity, i.e., whether the business opportunity is of sufficient importance and is so closely related to the existing or prospective activity of the corporation as to warrant judicial sanctions against its personal acquisition by a managing officer or director of the corporation.” Id. at 81. The Miller Court said that this question is best answered by a “flexible” inquiry into whether an opportunity was in a company’s “line of business” and recognized that the “inquiry of the fact finder should be directed to all facts and circumstances relevant to the question.” Id. The most significant of these factors include:

- whether the business opportunity presented is one in which the complaining corporation has an interest or an expectancy growing out of an existing contractual right;
- the relationship of the opportunity to the corporation's business purposes and current activities-whether essential, necessary, or merely desirable to its reasonable needs and aspirations;
- whether, within or without its corporate powers, the opportunity embraces areas adaptable to its business and into which the corporation might easily, naturally, or logically expand;
- the competitive nature of the opportunity-whether prospectively harmful or unfair;
- whether the corporation, by reason of insolvency or lack of resources, has the financial ability to acquire the opportunity; and
- whether the opportunity includes activities as to which the corporation has fundamental knowledge, practical experience, facilities, equipment, personnel, and the ability to pursue.

B. The second Miller step is to apply a "fairness" test. Those who are accused of usurping the corporate opportunity bear the burden of proving that they did not violate their fiduciary duties of loyalty, good faith, and fair dealing. Id. at 81. In this step, a court must again consider all relevant factors, with emphasis on:

- the nature of the usurper's relationship to the management and control of the corporation;
- whether the opportunity was presented to the usurper in his official or personal capacity;
- the usurper's prior disclosure of the opportunity to the corporation and the corporations' response;
- whether corporate facilities, assets, or personnel were used in misappropriating the opportunity; and
- whether the misappropriation harmed the corporation.

Id. at 81-82.

III. WHAT IS THE REMEDY?

A. Constructive Trust.

If a corporate opportunity is usurped for personal gain “the opportunity and any property or profit acquired becomes subject to a constructive trust for the benefit of the corporation.” Miller, 222 N.W.2d at 78; Diedrick v. Helm, 14 N.W.2d 913, 919 (Minn. 1944) (if “an officer or director diverts the opportunity and embraces it as his own, he is chargeable as a constructive trustee for the benefit of the corporation with all the profits and benefits received therefrom by him”). A constructive trust is a restitutionary remedy that is based upon the defendant’s gain from its wrongdoing, and not upon losses suffered by the plaintiff.

The essence of usurpation of a corporate opportunity is misappropriation. A corporate agent has taken something for himself that does not belong to him. Therefore, the purpose of a constructive trust remedy is to ensure that all of the benefits and profits that arise out of the opportunity ultimately inure to the corporation’s benefit and not the disloyal fiduciaries. “The corporate opportunity doctrine rests upon the broad foundation of public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of confidence imposed by the fiduciary relation.” 3 Fletcher Cycl. Of Private Corp. § 861.50 (2005). See Farber v. Servan Land Co., Inc., 541 F.2d 1086, 1088 (5th Cir. 1976) (corporation entitled to profit from sale of usurped opportunity, even if buyer would not have purchased from corporation); Hunter v. Shell Oil Co., 198 F.2d 485, 489 (5th Cir. 1952) (“When property has thus been wrongfully acquired, equity converts the holder into a trustee, and compels him to account for all gains from such conduct.”); Trice v. Comstock, 121 F. 620, 629-30 (8th Cir. 1903); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). The constructive trust remedy permits the plaintiff to “obtain, not merely what he lost, but gains received by the defendant from the

property's increase in value, from its transfer, from its use in a business operation." 1 Dan B. Dobbs, *Law of Remedies* § 4.3(2) at 592 (2d ed. 1993).

Intangible property as well as tangible property may be held in a constructive trust. Manker v. Manker, 644 N.W.2d 522, 534 (Neb. 2002) (intangible property as well as liquid assets such as stocks and bank and investment accounts may be held subject to a constructive trust); ABKCO Music, Inc. v. Harrisongs Music, Ltd., 722 F.2d 988, 996 (2d Cir. 1983) (ruling that "a constructive trust on the 'fruits' of ABKCO's [wrongful] acquisition [of music rights] was a proper remedy"); Tlapek v. Chevron Oil Co., 407 F.2d 1129, 1133-34 (8th Cir. 1969); Bausch & Lomb Inc. v. Alcon Laboratories, Inc., 64 F. Supp. 2d 233, 254 (W.D.N.Y. 1999) (constructive trust is an appropriate remedy when a party has wrongly used confidential information belonging to another); Chiu v. Wong, 16 F.3d 306, 310 (8th Cir. 1994) (right to a constructive trust arises "at the time of the wrongful conversion"); Shearer v. Barnes, 136 N.W. 861, 863 (Minn. 1912) (constructive trust arose when trust manager converted portion of funds to purchase realty).

"Where one person misappropriates property of another and converts it into another species of property, the defrauded party can assert equitable rights in the traceable product, unless the rights of a bona fide purchaser without notice have intervened." Thompson v. Nesheim, 159 N.W.2d 910, 916 (Minn. 1968). See Altman v. Altman, 47 N.W.2d 870, 871-72 (Minn. 1951); Anderson v. Bellino, 658 N.W.2d 645, 659 (Neb. 2003) (where employee usurped corporation's opportunity and diverted profits to a newly formed business in breach of his fiduciary duties, court did not err in imposing a constructive trust against the newly formed company and ordering that the corporation's interest in contract was for the benefit of plaintiff); Winger v. Chicago City Bank & Trust Co., 67 N.E.2d 265, 276-77 (Ill. Ct. App. 1946)

(constructive trust remedy allows beneficiary to obtain restitution of the property, assets, and earnings into which misappropriated assets have been converted).

B. Accounting

An accounting for profits is one of a category of traditionally restitutionary remedies in equity and is often invoked in conjunction with a constructive trust. See Parke v. First Reliance Standard Life Ins. Co., 368 F.3d 999, 1008 (8th Cir. 2004); Trieweiler v. Sears, 689 N.W.2d 807, 840-43 (Neb. 2004). A constructive trust is imposed when a defendant has possession of particular funds or property that in good conscience belong to the plaintiff. 1 Dan B. Dobbs, Law of Remedies § 4.3(1), at 587 (2d ed. 1993). An accounting is imposed when the property subject to the constructive trust produces profits while in the defendant's possession. The defendant is forced to disgorge those profits, although it is not necessary for the plaintiff to identify any particular res or fund of money holding the profits. See 1 Dobbs § 4.3(1), at 588 (“[A]ccounting does not seek any particular res or fund of money; the defendant will be forced to yield up profits, but the defendant can pay from any monies he might have, not some special account.”).

In an accounting, the burden is not on the plaintiff to prove the amount of defendant's profit to be disgorged; the burden shifts to the defendant to account for those profits. Farmers' Warehouse Ass'n v. Montgomery, 99 N.W. 776, 777 (Minn. 1904); Wilson v. Moline, 38 N.W.2d 201, 205-206 (Minn. 1949); see also Trieweiler, 689 N.W.2d at 840-43. 2004). Furthermore, “[o]nce the property has been traced into an indistinguishable mass, the party in the wrong then has the burden of distinguishing what portion of such property is justifiably his.” In re Wong, No. 4-91-396, 1994 WL 586965, *5-6 (Bankr. D. Minn. 1994) (Merrill Aff. Ex. C); Petersen v. Swan, 57 N.W.2d 842, 847 (Minn. 1953) (“[I]f it is impossible to make an equitable

division, the whole of the converted property should be held to be that of the one who has done no wrong.”).

C. The Consequential Benefits Measure

The Restatement (Second) of Torts defines compensatory damages for the torts that commonly accompany a claim for usurpation of corporate opportunity as “the damages awarded to a person as compensation, indemnity or restitution for harm sustained by him.” Restatement (Second) of Torts § 903 (1979). Restitutionary damages are measured by the gain/unjust enrichment received by defendants from the wrongful taking of the opportunity – which is determined by reference to the sale price received pursuant to the merger transaction. 1 Dan B. Dobbs, Law of Remedies § 4.1(4), at p. 566 (2d ed. 1993). Consequential benefits are the value that the usurped opportunity “produces in the hands of the defendant.” Id. From those consequential benefits, it is appropriate to deduct the identifiable costs of obtaining those benefits.

Moreover, consequential benefits are not measured merely on the date of the wrongful conduct, but instead include the gains received by the defendants thereafter that in good conscience belong to the plaintiff. Id.; Miller, 222 N.W.2d at 78 (observing that it is well-recognized that the remedy for usurping a corporate opportunity must ensure that the opportunity and “any property or profit” gained from it go to the corporation’s benefit and not the disloyal fiduciaries). Dobbs offers the following example:

D, a fiduciary agent, violates her duty by using her employer’s secret information about the probable location of a profitable vein of gold. She could sell the information to a mining company for \$100,000 in the period immediately after she has taken it. However, she does not in fact sell the information but instead, one year after her illicit acquisition of the information, she purchases rights to mine the land in question for herself. Release of the information at that point would drive the price of the mining rights

up to give her \$500,000 gain. But she mines the gold herself, and within two years later she has net income gains of \$1,000,000. If the employer brings suit at this point it could recover her \$1,000,000 gains (perhaps with deductions for expenses and her own efforts) and would not be limited to a recovery of the \$100,000 market value of the information at the date it was acquired.

Dobbs, Law of Remedies § 4.5(3), at p. 637 n. 2.

IV. WHO CAN BE LIABLE FOR USURPATION OF A CORPORATE OPPORTUNITY?

Liability for usurpation of a corporate opportunity is not limited to directors and officers. Employees, agents and successors in interest may also be held liable. The Minnesota Supreme Court has declared that the corporate opportunity doctrine is based on “fundamental rules of agency concerning the duty of utmost good faith and loyalty owed by a fiduciary to his principal.” Miller v. Miller, 222 N.W.2d 71, 78 (Minn. 1974). Whether or not the doctrine applies is not determined by a person’s title, but rather by the fiduciary relationship that carries with it the duty of loyalty of an agent to the principal.

A. Employees/Agents

An employee is an agent of his or her employer, and therefore, owes the employer/principal a fiduciary duty of loyalty. Encompassed within the duties of an agent is a duty to disclose relevant information to the principal, and the duty to not compete with the principal. See Restatement (Second) of Agency §§ 381, 393 (1957). Minnesota courts have stated generally that “all employees, to a lesser or greater extent, have a fiduciary relationship to their employers, . . . with a duty to act in the interests of the employer and not as an adversary.” State by McClure v. Sports and Health Club, Inc., 370 N.W.2d 844, 858 (Minn. 1985) (citing Restatement (Second) Agency §§ 1, 2, 13 (1958)). Similarly, employers have a legitimate interest in protecting themselves against “the deflection of trade or customers by the employee

by means of the opportunity which the employment has given him.” Webb Publ’g Co. v. Fosshage, 426 N.W.2d 445, 450 (Minn. Ct. App.1988). Accordingly, employees as fiduciaries have a duty of loyalty to their employer and may not misappropriate or solicit business of their employer. See, e.g., Electro-Craft Corp. v. Controlled Motion, Inc., 332 N.W.2d 890, 903 (Minn. 1983) (misappropriating information the employer has treated as a secret violates employee’s duty of confidentiality); Rehabilitation Specialists, Inc. v. Koering, 404 N.W.2d 301, 304 (Minn. 1987) (every employee owes a duty of loyalty to his employer). Whitten v. Wright, 289 N.W. 509, 510-11 (Minn. 1939) (employee had duty to inform his employer of opportunity he usurped for himself; constructive trust imposed on opportunity and its proceeds). See Triple Five, 404 F.3d at 1097 (partner held liable for usurpation; applying Minnesota law); Tlapek v. Chevron Oil Co., 407 F.2d 1129, 1133-34 (8th Cir. 1969) (holding that former oil company employee violated his fiduciary duty by obtaining oil leases based upon theory he developed while employed as company’s geologist; constructive trust imposed); Trice v. Comstock, 121 F. 620, 629-30 (8th Cir. 1903) (holding that employee/agent violated his fiduciary duty and usurped opportunity by purchasing land for himself).¹ As the Restatement of Agency, provides:

all agents, even those whose assigned work does not involve the assessment or pursuit of business opportunities, have a fiduciary duty to the principal not to take personal advantage of an opportunity and not to give the opportunity to a third person, when either the nature of the opportunity or the circumstances under which the agent learned of it require that the agent offer the opportunity to the principal.

Restatement (Third) of Agency § 8.02(d).

¹ See also Prodrornos v. Everen Sec., Inc., 793 N.E.2d 151, 159 (Ill. App. 2003); Berenson v. Nirenstein, 93 N.E.2d 610 (Mass. 1950); Gomez v. Bicknell, 756 N.Y.S.2d 209, 213 (N.Y. App. Div. 2002); IBE Trade Corp. v. Litvinenko, 748 N.Y.S.2d 741 (N.Y. App. Div. 2002); Hill v. Southeastern Floor Covering Co., 596 So. 2d 874, 878 (Miss. 1992).

In Benchmark Medical Holdings, Inc. v. Rehab Solutions, LLC, 307 F. Supp. 2d 1249 (M.D. Ala. 2004) (applying Delaware law), the defendant argued that a usurpation of corporate opportunity claim applies only to corporate officers and directors, not employees. The court rejected this argument, stating that courts “must look beyond a simple classification of someone as an employee, rather than a corporate officer or director, to focus on applying agency law to determine if they are liable.” Id. at 1266. The court further observed that: “When the Defendant attempts . . . to impose a bright line rule that one cannot be liable for usurpation of a corporate opportunity as an employee, a theory that the Plaintiff breached his duty of loyalty as an agent provides a means of avoiding such a bar and points out the practical problems with the limitation that the Defendant seeks to impose.” Id.

B. Successors in Interest

Successors in interest to a corporation may also be held liable for usurpation of a corporate opportunity. “[w]here one person misappropriates property of another and converts it into another species of property, the defrauded party can assert equitable rights in the traceable product, unless the rights of a bona fide purchaser without notice have intervened.” Thompson v. Nesheim, 159 N.W.2d 910, 916 (Minn. 1968). See Altman v. Altman, 47 N.W.2d 870, 871-72 (Minn. 1951); Anderson v. Bellino, 658 N.W.2d 645, 659 (Neb. 2003) (where employee usurped corporation’s opportunity and diverted profits to a newly formed business in breach of his fiduciary duties, court did not err in imposing a constructive trust against the newly formed company and ordering that the corporation’s interest in contract was for the benefit of plaintiff); Winger v. Chicago City Bank & Trust Co., 67 N.E.2d 265, 276-77 (Ill. Ct. App. 1946) (constructive trust remedy allows beneficiary to obtain restitution of the property, assets, and earnings into which

misappropriated assets have been converted). Therefore, if a misappropriation is converted into a newly formed company the plaintiff should be entitled to assert equitable rights.

V. HOW CAN A CORPORATE OFFICER/DIRECTOR/AGENT AVOID LIABILITY?

A. Disclosure and Ratification

If the transaction itself does not violate a statute or public policy, the shareholders of a corporation ordinarily can ratify the transaction. Safety Int'l, Inc. v. Dyer, 775 F.2d 660 (5th Cir. 1985). Assuming fairness to the corporation and full disclosure, only a majority vote is necessary to ratify the transaction, and even when the transaction is detrimental to the corporation, no cause of action will lie if all of the shareholders have ratified the transaction. Id.

Section 8.70 of the Model Business Corporation Act provides a safe harbor for a director considering a business opportunity. In those states in which Section 8.70 has been adopted, a director considering a business opportunity may be safe from liability if, before becoming legally obligated with respect to the opportunity, he discloses the opportunity and a director or shareholder action disclaiming the corporation's interest in the opportunity. 3 Fletcher Cycl. of the Law of Corp. § 862.30 (2007); Model Bus. Corp. Act § 8.70(b). No cases have been located which indicate that Minnesota has adopted Section 8.70 of the Model Business Corporation Act.

VI. DOES THE CORPORATE OPPORTUNITY DOCTRINE APPLY TO ENTITIES OTHER THAN CORPORATIONS?

A. Partnerships

The corporate opportunity doctrine also applies to partnerships. A partner may not appropriate a business opportunity which rightfully belongs to the partnership. Triple Five of Minnesota, Inc. v. Simon, 404 F.3d 1088, 1096 (8th Cir. 2005). An opportunity that is closely related to the entity's existing or prospective line of business, would competitively advantage the partnership, and is one that the partnership has the financial ability, knowledge and experience to pursue is a partnership opportunity. Id. As with corporations, the determination of whether an opportunity rightly belongs to the partnership is necessarily one of fact. Id. at 1096-97.

B. Limited Liability Companies

Although no specific case law regarding the application of the corporate opportunity doctrine to a limited liability company could be located, it is likely that it would apply to a limited liability company because the doctrine is based upon good faith and loyalty owed by a fiduciary.