

Opportunity Knocks: Proposed Legislative Reform of the Corporate Opportunity Doctrine in Michigan

By Edwin J. Lukas

Introduction

Directors and officers of Michigan corporations are required to act in the best interests of the corporation and its shareholders.¹ Frequently, individuals serving a corporation in a fiduciary capacity acquire information regarding a corporate opportunity—including potential acquisitions, business combinations and prospective agreements, licenses or other relationships with third parties—that may be beneficial to the corporation and in which the corporation has a legitimate interest. Directors and officers who pursue such an opportunity for private gain or the benefit of another, without having first presented it to the corporation, are said to have “appropriated” or “usurped” an opportunity to which the corporation is entitled. Moreover, individuals who are required to discharge fiduciary duties to more than one entity may be confronted with an irresolvable conflict when numerous entities may lay claim to the same corporate opportunity.

Directors and officers must make difficult decisions when confronting corporate opportunities. Determining whether a specific business opportunity constitutes a “corporate opportunity” for purposes of the doctrine, as well as identifying the specific actions that must be taken to avoid significant potential liability to the corporation and its shareholders, are tasks that require careful analysis and thoughtful execution.

Recognizing the complexity of the analysis and the need to empower corporations to govern themselves effectively in this regard, several states have enacted statutory provisions permitting corporations to renounce, in advance, certain specified opportunities or classes of opportunities to which the corporation would otherwise be entitled. Although the Michigan Business Corporation Act (the “MBCA”)² currently authorizes corporations to disclaim corporate opportunities under certain circumstances, the statutory provisions are inadequate in some important ways. This article proposes that the Michigan

Legislature amend the MBCA by authorizing Michigan corporations to adopt advance renunciation provisions in their articles of incorporation or by board action. The MBCA, as so amended, would eliminate time-consuming processes that currently must be followed by corporations, afford directors and officers greater protection from potential liability, and encourage Michigan-based business enterprises that frequently appoint persons to multiple board positions to select Michigan as their jurisdiction of incorporation.

Factual Scenarios

Consider the following hypothetical examples that illustrate the dilemma that must be resolved by directors and officers of a corporation when presented with a corporate opportunity.

Joint Venture

Mackenzie is an executive officer of Electric Vehicle Co. (EVC), a corporation that manufactures and distributes technologies for battery electric vehicles. EVC holds a majority interest in HybridTech, Inc. (HTI), a joint venture that develops technologies for vehicles combining the internal combustion engine of a conventional vehicle with the battery and electric components of an electric vehicle. Mackenzie, who was previously appointed to serve on the board of HTI, is approached by an officer of New Cars, LLC (“New Cars”), an original equipment manufacturer that produces and exports passenger vehicles incorporating green technology. New Cars is seeking a long-term supply agreement for clean engines as part of a new vehicle platform, and both EVC and HTI are suitable suppliers. Mackenzie, however, believes that the agreement may be better suited for HTI, and she is perplexed over whether she may direct the opportunity to HTI without breaching her fiduciary duties to EVC.

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Venture Capital Fund

DeAnn is the managing director of Savvy Ventures, LLC (SV), a venture capital fund focused on biotechnology, medical devices, and related technologies. DeAnn is also a director of one of SV's portfolio companies, Spinal Fusion Corp. (SFC), which develops and distributes prosthetic spinal disc devices. While attending a venture capital symposium, DeAnn learns about Precise Surgery, Inc. (PSI), a corporation developing alternative, minimally invasive surgical technologies. Although PSI is seeking follow-on financing, its founding shareholders are willing to consider a sale of the company. Notwithstanding her conclusion that SFC would benefit from acquiring PSI's assets or stock, DeAnn determines that the opportunity may be best suited for direct acquisition by SV, much to the dismay of certain shareholders of SFC.

Spin-Off and IPO

Spencer is the majority shareholder and chairman of the board of Global Toys Co. ("Global"), a manufacturer and distributor of games, books, and educational toys. Global recently completed the spin-off of Sleepy Time, Inc. ("Sleepy"), a former subsidiary of Global that specializes in the publication of e-books and related online content that are suitable for children. Following Global's distribution to its shareholders of all the outstanding shares of Sleepy's common stock and Spencer's appointment to Sleepy's board, Sleepy raises capital by engaging in an initial public offering of common stock. Following the IPO, Spencer is approached by an executive from a major Hollywood studio regarding the development and distribution of toys, books, and Internet content featuring characters from a recent hit movie. Spencer refers the opportunity to Global but subsequently realizes that the opportunity is squarely within the scope of prospective business recently highlighted to Sleepy's board during a strategic review.

The foregoing examples illustrate the untenable position of a director or officer facing what is frequently an irresolvable conflict of interest, and one could reasonably foresee an action being brought by or in the right of a corporation under each of the circumstances described above. A director or officer who is found to have breached the duty of loyalty to the corporation by appropriating a corporate opportunity is subject to a host of potential

sanctions, including monetary damages and equitable relief.³

Development of the Doctrine

Directors and officers of a Michigan corporation owe fiduciary duties to the corporation and its shareholders.⁴ One of the essential duties is the duty of loyalty, which prohibits directors and officers from using their positions of trust to further their private interests to the detriment of the corporation.⁵ The MBCA also establishes a statutory standard of conduct in Section 541a, which requires directors and officers to discharge the duties of his or her position in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner that he or she believes to be in the best interest of the corporation.⁶ Individuals who are vested with fiduciary duties, however, are not required to conduct all of their personal business matters in their capacity as a director or officer of the corporation.⁷ Nevertheless, they cannot disregard their obligations to the corporation and its shareholders by appropriating business opportunities that properly belong to the corporation.⁸ For this reason, there exists a tension between a director and officer's responsibility to the corporation and their right to conduct their own private affairs.

The corporate opportunity doctrine developed through the common law in an effort to address the conflict that must be resolved by a director or officer evaluating an opportunity that may belong to the corporation.⁹ The common law has produced numerous iterations of the corporate opportunity doctrine, most of which find their basis in the seminal Delaware case of *Guth v Loft, Inc.*¹⁰ Generally, the doctrine provides that when a corporate opportunity is presented to a director or officer, he or she may not pursue the opportunity for personal benefit or the benefit of another to which the corporate official similarly owes a fiduciary duty, if (a) the corporation is financially able to undertake the opportunity, (b) the opportunity is within the corporation's line of business, (c) the corporation has an interest or reasonable expectancy in the opportunity, and (d) by taking the opportunity, the interest of the fiduciary will conflict with the interests of the corporation.¹¹ Further, the court in *Guth* also established the basis for a corollary rule providing that a director or officer may take a corporate opportunity if (a) the opportunity is presented to

the director or officer in his or her individual capacity, (b) the opportunity is not essential to the corporation, (c) the corporation holds no interest or expectancy in the opportunity, and (d) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.¹² Although a few Michigan cases have followed the principles announced in *Guth*,¹³ the case law in Michigan is not particularly well developed with respect to the doctrine.

Michigan Statutory Considerations

Certain provisions in the MBCA implicitly authorize Michigan corporations to renounce corporate opportunities and permit directors or officers to pursue them independently. For example, Section 488 of the MBCA allows shareholders to formalize an agreement governing the exercise of corporate powers, management of the corporation's affairs, or the relationships among the shareholders, directors, and the corporation, provided the agreement is not contrary to public policy.¹⁴ Section 488 requires that such an agreement be set forth in the corporation's charter or bylaws or in a document signed by the shareholders.¹⁵ Thus, Section 488 certainly provides a basis for a corporation to adopt charter or bylaw provisions governing corporate opportunities, provided the corporation is able to satisfy the remaining statutory requirements.

Assuming that an agreement adopted pursuant to Section 488 and related to corporate opportunities would survive a public policy challenge, certain provisions in the statute should cause practitioners to be cautious when relying on its terms. For example, Section 488(2)(a) requires that an agreement related to the matters set forth in the statute be approved by all of the shareholders at the time of the agreement.¹⁶ Section 488(10), however, states that the failure to satisfy the unanimity requirement of Section 488(2) does not invalidate an agreement that would otherwise be considered valid.¹⁷ Presumably, the latter provision prevails and, absent unrelated charter or bylaws provisions requiring a greater degree of shareholder approval, a charter amendment or bylaw provision approved by a majority of the shares entitled to vote would be considered valid. Nevertheless, the ambiguity presented by Section 488 warrants careful consideration when shareholder unanimity may not be achieved.

More importantly, an advance renunciation provision adopted pursuant to Section 488 ceases to be effective when the corporation's shares become publicly traded.¹⁸ Thus, directors and officers of a corporation that has adopted charter or bylaw provisions related to corporate opportunities, but that is contemplating or has completed an initial public offering, lose the benefit of the statutory provisions upon completion of the IPO.

Another statutory resource for practitioners addressing corporate opportunities is Section 545a of the MBCA. This statute governs interested director and officer transactions and prohibits injunctive relief and sanctions from being imposed as a result of the transaction. Pursuant to Section 545a, a transaction in which a director or officer is determined to have an interest may not be the subject of injunctive relief or an award of damages in a lawsuit by a shareholder or by or in the right of the corporation, as long as the director or officer establishes the transaction was either (a) fair to the corporation at the time entered into or (b) approved by a majority of disinterested directors or shareholders.¹⁹ In connection with seeking board or shareholder approval, the director or officer must disclose all material facts related to the transaction and the director or officer's interest in the same.²⁰

In the context of Section 545a, the question that arises is whether a prospective business opportunity in which both the corporation and the director or officer may have an interest constitutes a "transaction" that is subject to the statutory procedures and protection. Stated differently, it is unclear whether a director or officer who refrains from pursuing an opportunity and discloses it to the board or shareholders for approval has, in fact, disclosed an interested "transaction" thereby entitling the director and officer to the protection afforded by Section 545a. The term "transaction" suggests that the subject event or condition has occurred and the parties to or participants in the same have been established. A business opportunity, on the other hand, may be properly characterized as a set of favorable circumstances that may lead to a transaction between parties that are yet to have been clearly identified.

Leading commentators have also noted that Section 545a is not designed to "validate" an interested transaction.²¹ While the statute assures that, as long as the conditions set forth in the statute are met, an interested

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director or officer transaction cannot be enjoined because of the interest, other grounds for a challenge may remain available.²² As such, the statute does not provide directors or officers with an absolute safe harbor from potential liability. Assuming that a corporate opportunity constitutes a “transaction” for purposes of Section 545a, directors and officers may nevertheless have fiduciary duties to more than one legal entity, and obligations related to confidentiality may prohibit such a person from disclosing the opportunity to more than one company and obtaining the statutory protection with respect to the latter organization.

Regardless whether a director or officer’s disclosure of corporate opportunities to the board or shareholders fits squarely within the confines of Section 545a, corporate policies and procedures requiring case-by-case disclosure have their limitations. On receipt of such a disclosure, the board or shareholders must undertake fact-intensive inquiries of each opportunity that is presented to them and determine whether the opportunity is a “corporate opportunity” that it wishes to pursue. The corporation, of course, is not required to disclaim or renounce its interest in the opportunity. Following consideration of the material facts presented in the disclosure of the prospective opportunity, the corporation may (a) disclaim its interest in the opportunity, (b) decline to disclaim its interest, (c) delay a decision with respect to the request for disclaimer pending receipt from the director or officer of additional information (or for any other valid reason), or (d) attach conditions to the disclaimer granted.²³

As a result, requiring directors and officers to seek disclaimers for each corporate opportunity on a case-by-case basis can be a time-consuming process, and the outcome is often unpredictable for all of the parties involved. Even in those instances in which a corporate official discloses an opportunity to the corporation and it is disclaimed, the director or officer cannot be absolutely certain that retention of the opportunity for personal gain will not be subject to later challenge by or on behalf of the corporation.

Proposed Statutory Response

In *Siegman v TriStar Pictures Inc.*,²⁴ the Delaware Court of Chancery cast doubt on whether a Delaware corporation could define in its certificate of incorporation the scope of those opportunities that belonged to the cor-

poration.²⁵ Recognizing the uncertainty created in large part by *TriStar*, the Delaware Legislature amended the Delaware General Corporation Law (the “DGCL”) in 2000. As a result of the amendments to Section 122 of the DGCL, which enumerates the general powers of Delaware corporations, the DGCL conclusively established that a corporation has the power to renounce, in advance, in its certificate of incorporation or by action of its board of directors, “any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders.”²⁶ To the extent there existed any ambiguity under Delaware law regarding a Delaware corporation’s power to regulate potential conflicts that arose in the context of corporate opportunities, that ambiguity was resolved by Section 122(17). Several states, including Kansas, Missouri, Nevada, Oklahoma, and Texas, have subsequently adopted statutory amendments that are substantially similar to the Delaware provisions.²⁷

Section 261 of the MBCA enumerates the powers of Michigan corporations. This statute should be amended to authorize corporations to make an advance renunciation of any interest or expectancy in specified business opportunities or classes or categories of opportunities. The proposed amendments to Section 261 are italicized in the following:

450.1261 Corporate powers.

Sec. 261

A corporation, subject to any limitation provided in this act, in any other statute of this state, or in its articles of incorporation, shall have power in furtherance of its corporate purposes to do all of the following:

(s) *To renounce, in its articles of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or classes or categories of business opportunities that are or may be in the future presented to the corporation, one or more of its officers, directors or shareholders.*

Regardless whether a director or officer’s disclosure of corporate opportunities to the board or shareholders fits squarely within the confines of Section 545a, corporate policies and procedures requiring case-by-case disclosure have their limitations.

Numerous benefits may be derived from the proposed amendments. The imperfections and ambiguities presented by Section 488 and Section 545a of the MBCA in the context of corporate opportunities would be remedied. Corporations would be authorized to define, specifically or generally, the scope of the corporate opportunities to which they are entitled. Requiring directors and officers to present each potential opportunity to the board or shareholders, and wait for the board or shareholders to consider and disclaim each opportunity, is not practical or desirable. Corporate opportunities frequently require swift and decisive action.

As explained above, in those circumstances in which a director or officer owes concomitant duties to more than one entity, a case-by-case disclaimer does not necessarily insulate the director or officer from related challenges. Charter provisions that define the class or categories of opportunities that are suitable for the corporation, while renouncing or disclaiming those in which it has no interest, would foster a director or officer's ability to serve more than one company without violating his or her duties to any of them. The revised statute would also facilitate the adoption of allocation agreements and other contractual commitments among the interested parties, resulting in more clearly defined opportunities to which each party is entitled.

Moreover, business enterprises that invest in a host of affiliates, such as venture capital funds and real estate companies, frequently appoint individuals to serve on the boards of numerous related entities. The proposed statutory amendments would potentially encourage fund managers and others with Michigan-based investments to select Michigan as the jurisdiction of incorporation for their business interests.

Conclusion

Adopting the proposed amendments to the MBCA would eradicate the uncertainty facing directors and officers of Michigan corporations in the context of the corporate opportunity doctrine. These provisions would assist Michigan corporations in governing themselves efficiently and, as long as directors and officers adhere to the scope of the renunciation or disclaimer adopted by their corporations, the prospect of potential liability for violating the corporate opportunity doctrine would be diminished appreciably for them.

NOTES

1. MCL 450.1541a(1)(c).
2. MCL 450.1101 et seq.
3. See, e.g., *Guth v Loft, Inc*, 5 A2d 503 (Del 1939).
4. See, e.g., *Pikes Peak Co v Pfunter*, 158 Mich 412 (1909); *Thomas v Satfield Co*, 363 Mich 111 (1961); *Salvadore v Connor*, 87 Mich App 664 (1978).
5. See, e.g., *Guth v Loft, Inc*, 5 A2d 503 (Del 1939).
6. MCL 450.1541a.
7. See Drexler, Black, and Sparks, *Delaware Corporation Law and Practice*, Sec. 15.08 (2003).
8. *Id.*
9. See, e.g., *Broz v Cellular Info Sys, Inc*, 673 A2d 148 (Del 1996).
10. *Guth v Loft, Inc*, 5 A2d 503 (Del 1939).
11. *Id.* at 510-511.
12. *Id.* at 509. For a detailed discussion of the development of the corporate opportunity doctrine under Delaware law, see Drexler, Black and Sparks, *Delaware Corporation Law and Practice*, Sec. 15.08 (2003).
13. See, e.g., *Production Finishing Corp v Shields*, 158 Mich App 479, 485-486, 405 NW2d 171 (1987). See also *In re Sullivan*, 305 BR 809 (Bankr WD Mich 2004); *SCD Chem Distribs, Inc v Medley*, 203 Mich App 374, 512 NW2d 86 (1994); *Rapistan Corp v Michaels*, 203 Mich App 301, 511 NW2d 918 (1994); *Cent Cartage Co v. Fewless*, 232 Mich App 517, 591 NW2d 422 (1998).
14. MCL 450.1488(1)(h).
15. MCL 450.1488(2).
16. MCL 450.1488(2)(a).
17. MCL 450.1488(10).
18. MCL 450.1488(4).
19. MCL 450.1545a(1).
20. MCL 450.1545a(1)(b).
21. See Schulman, Moscow and Lesser, *Michigan Corporation Law and Practice*, Sec. 5.13, p. 183.
22. *Id.* at 184.
23. Model Business Corporation Act (4th ed 2008), Sec. 8.70, Official Comment, p. 8-568.
24. *Siegman v TriStar Pictures, Inc.*, CA 9477, 1989 Del Ch LEXIS 56 (May 5, 1989).
25. *Id.*
26. 8 Delaware Code, Sec. 122(17).
27. See Kansas Code, Sec. 17-6102(17); Mo Revised Stat, Sec. 351.385(16); Nevada Rev Stat, Sec. 78.070(8); 18 Okla Stat Ann, Sec. 1016(17); Tex Bus Corp Act Ann, art 2.02(20).



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