



# Michigan's Corporate Opportunity Doctrine

## Understanding the *Production Finishing* and *Rapistan* Decisions

By David F. Hansma

**T**he corporate opportunity doctrine provides an important supplement to contract-based noncompetition obligations. At bottom, the corporate opportunity doctrine states that a corporate fiduciary's duties of good faith and loyalty forbid him from appropriating to himself business opportunities that, by right, belong to his principal. The corporate opportunity doctrine protects opportunities that rightfully belong to the corporation, thus providing an important protection against faithless servants.<sup>1</sup>

Unfortunately, Michigan law on the corporate opportunity doctrine is less than clear. Two Michigan cases—*Production Finishing v Shields*<sup>2</sup> and *Rapistan Corporation v Michaels*<sup>3</sup>—have set forth different definitions of the doctrine. I submit that *Rapistan* intended only to apply Delaware law and did not intend to set forth Michigan law. In addition, *Rapistan*, which

focuses initially on how the opportunity is presented, is an inferior rule to *Production Finishing*, which focuses exclusively on the nature of the opportunity at issue.

### *Production Finishing* and *Rapistan*

In *Production Finishing*, defendant Shields was an officer and director of Production Finishing, a company providing steel-polishing services to the automotive industry. Production Finishing sought to do polishing work for Ford Motor Company. When Shields learned that Ford intended to close its polishing plant and outsource that work, he approached Ford on behalf of Production Finishing. Ford refused to give Production Finishing the business.<sup>4</sup> Without disclosure to Production Finishing's board of directors, Shields pursued the Ford business in his individual capacity.<sup>5</sup>

The Court of Appeals held “as a matter of law” that Shields “breached his fiduciary duties to the corporation by diverting a corporate business opportunity for his own personal gain.”<sup>6</sup> The Court explained:

A corporate officer or director is under a fiduciary obligation not to divert a corporate business opportunity for his own personal gain. The rule is that if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake which is, from its nature, in the line of the corporation’s business and is of practical advantage to it, and which is one in which the corporation has an interest or a reasonable expectancy, and if, by embracing the opportunity, the self interest of the officer or director will be brought into conflict with that of this corporation, the law will not permit him to seize the opportunity for himself. If he does, the corporation may claim the benefit of the transaction.<sup>7</sup>

The Court also held that Ford’s refusal to deal with Shields’s employer did not excuse Shields’s failure to disclose his activities to Production Finishing’s board of directors:

For the reason that the firmness of a refusal to deal cannot be adequately tested by the corporate executive alone, it has not been favored as a defense unless the refusal has first been disclosed to the corporation. . . . [B]efore a person invokes refusal to deal as a reason for diverting a corporate opportunity he must unambiguously disclose that refusal to the corporation to which he owes a duty, together with a fair statement of the reasons for that refusal.<sup>8</sup>

In justifying a duty to disclose even when there is a refusal to deal, the Court explained, “[I]f financial disabilities or third-party refusals to deal with the corporation are accepted as tests, the inevitable result will be to permit the diversion. This is true because courts must resolve the legal issues on the basis of a set of facts largely within the control of the diverter.”<sup>9</sup>

Unfortunately, the Court of Appeals introduced a different rule in *Rapistan Corporation v Michaels*. In that case, two Delaware corporations alleged that the defendants usurped corporate opportunities belonging to the plaintiffs. The Court of Appeals applied the “*Guth* Rule” and “*Guth* Corollary” from the Supreme Court of Delaware’s decision in *Guth v Loft, Inc.*<sup>10</sup> The Court of Appeals quoted the *Guth* Rule as follows:

[I]f there is presented to a corporate officer or a director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation’s business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.<sup>11</sup>

## AT A GLANCE

The corporate opportunity doctrine states that a corporate fiduciary’s duties of good faith and loyalty forbid him from appropriating to himself business opportunities that, by right, belong to his principal.

The focus of liability should be on the nature of the opportunity taken, not on the capacity in which the opportunity is offered to the fiduciary.

The doctrine should not be limited to officers and directors, but any corporate agent who takes an opportunity within the scope of his agency.

The Court of Appeals also quoted the *Guth* Corollary:

It is true that when a business opportunity comes to a corporate officer or director in his individual capacity rather than in his official capacity, and the opportunity is one which, because of the nature of the enterprise, is not essential to his corporation, and is one in which it has no interest or expectancy, the officer or director is entitled to treat the opportunity as his own, and the corporation has no interest in it if, of course, the officer or director has not wrongfully embarked the corporation’s resources therein.<sup>12</sup>

Applying *Guth*, the *Rapistan* Court set forth a three-step process for applying the corporate opportunity doctrine:

- First, a court “must ascertain whether the opportunity is presented to a corporate officer in the officer’s individual or representative capacity.”
- Second, “the court must determine the nature of the opportunity.”
- Third, “the nature of the opportunity is analyzed differently, depending on whether the opportunity is presented to a corporate official in the official’s individual or corporate representative capacity.”<sup>13</sup>



The Court emphasized, "Delaware law required [that the trial court] view the nature of the opportunity in light of the capacity of the corporate officer when the opportunity was received."<sup>14</sup> Thus, the Court affirmed the trial court's decision that "whether the nature of the opportunity presented [to the defendants] was corporate depended on whether the opportunity was first presented to [the defendants] in their capacities as individuals or as corporate representatives."<sup>15</sup>

### Where do *Rapistan* and *Guth* fit into Michigan law?

The parties at issue in *Rapistan* were Delaware corporations, and the Court of Appeals made clear that it was applying Delaware law.<sup>16</sup> Nevertheless, Michigan courts have cited *Rapistan* as providing a rule of decision in cases governed by Michigan law.<sup>17</sup> In *Corporate Auto Resource Specialists, Limited v Pruitt*, the Oakland County Business Court specifically held, "Michigan Courts have adopted the *Guth* Rule."<sup>18</sup> The author submits that because *Rapistan* does not purport to be a statement of Michigan law on the corporate opportunity doctrine, Michigan courts should apply the corporate opportunity doctrine as set forth in *Production Finishing*.

### What's the difference?

Admittedly, the *Rapistan* and *Production Finishing* formulations of the corporate opportunity doctrine appear similar and consider similar elements. But *Rapistan*'s application of the *Guth* Rule and *Guth* Corollary differs materially from the *Production Finishing* rule.

First, *Rapistan* is not an entirely accurate application of *Guth*. By devising a three-stage test with the initial focus on the "individual versus corporate representative capacity distinction,"<sup>19</sup> the *Rapistan* decision is contrary to *Guth*'s warning that the "question is not one to be decided on narrow or technical grounds, but upon broad considerations of corporate duty and loyalty."<sup>20</sup> More recently, the Supreme Court of Delaware has recognized that *Guth* and its progeny "provide guidelines to be considered by a reviewing court in balancing the equities of an individual case. No one factor is dispositive and all factors must be taken into account insofar as they are applicable."<sup>21</sup> Indeed, the Supreme Court of Delaware gave little consideration to whether *Guth* first obtained the opportunity in his individual capacity.<sup>22</sup> Instead, the Court held, "The real issue is whether the opportunity to secure a very substantial stock interest in [Pepsi] was so closely associated with the existing business activities of Loft, and so essential thereto as to bring the transaction within that class of cases where the acquisition... would

throw the corporate officer purchasing it into competition with his company."<sup>23</sup>

Notably, the language of the *Guth* Corollary suggests that the individual versus corporate representative distinction should not be the guiding factor. The corollary contains four factors: one stated in the positive and three stated in the negative. The positive factor is that the opportunity "comes to the corporate officer or director in his individual capacity[.]"<sup>24</sup> The three negative factors are that the opportunity is not essential to the defendant's corporation; is one in which the corporation has no interest or expectancy; and the defendant has not wrongfully embarked the corporation's resources.<sup>25</sup> To satisfy the corollary, the opportunity must satisfy all four factors. In other words, even if the opportunity is presented to the fiduciary in his individual capacity, the negative conditions are imposed on the fiduciary before he may take advantage of the opportunity.

There is wisdom in focusing on the nature of the opportunity rather than its presentation. This can be seen from *Production Finishing*'s discussion of the related issue of a refusal to deal. The refusal-to-deal argument says, "The opportunity is not a corporate opportunity because the offeror refuses to deal with the corporation." But, as explained in *Production Finishing*, a duty to disclose exists even in cases of a refusal to deal because "courts must resolve the legal issues on the basis of a set of facts largely within the control of the diverter."<sup>26</sup> The relation to the "individual capacity" issue is apparent. Shields, for example, could have argued that the opportunity was presented to him individually because Ford never intended to give the work to *Production Finishing*. Thus, similar to the refusal-to-deal argument, focusing on the individual capacity versus corporate capacity distinction creates the opportunity for fiduciaries to control their liability by controlling the facts. The party offering the opportunity and the fiduciary taking the opportunity could easily collude, either beforehand or in later testimony, to suggest that an opportunity was first presented to the fiduciary individually. The *Production Finishing* rule avoids this outcome.

### Who is subject to the corporate opportunity doctrine?

The *Guth* and *Rapistan* decisions also raise a question of which corporate actors are subject to the corporate opportunity doctrine. Some states hold that the doctrine only applies to officers, directors, and majority shareholders.<sup>27</sup> At least one Michigan court, relying on *Guth*, has held the same.<sup>28</sup>

Such a restriction on the scope of the corporate opportunity doctrine is not desirable or consistent with Michigan law under *Production Finishing*. While *Production Finishing*

frequently makes reference to the fiduciary duties owed by “directors and officers,”<sup>29</sup> the decision applied more general agency principals. The Court explained:

[I]t is an elemental rule of agency that [Shields’s] duties required his efforts and activities in the line of his employment should be for the benefit of his principal, and he was not at liberty to deal in the business of his agency for his own benefit. It was his duty to communicate to his principal facts relating to the business which ought in good faith be made known to the latter[.]<sup>30</sup>

Subsequent Michigan cases have made this abundantly clear. In *Central Cartage Co v Fewless*, the Court of Appeals held that “all profits made in the execution of a fiduciary’s agency belong to the principal.”<sup>31</sup>

Application of the corporate opportunity rule to employees is the more desirable rule. Obviously, whether a given employee breached a fiduciary duty by appropriating an opportunity will depend on the facts. A janitor may not be subject to the same fiduciary duties as a regional sales manager because the scope of his agency is different. But the regional sales manager should not escape liability for taking an opportunity within his principal’s interests simply because he is not an officer or director.

Applying the corporate opportunity rule to employees is also not overly restrictive on competition. Michigan law is clear that, subject to contractual restrictions, Michigan employees are free to compete once they have left their employment. Indeed, in *Central Cartage*, the Court of Appeals held that an employee breached his fiduciary duties by taking an opportunity during his employment, but he could benefit from the same opportunity after terminating his employment and advising his employer of the situation.<sup>32</sup> Michigan law also allows employees to prepare to compete before terminating their employment.<sup>33</sup>

In other words, Michigan employees who desire to compete against their former employers are free to do so. They are even free to prepare to do so while they still owe a duty of loyalty to their employer. It is not too much to ask that they be held accountable for competition against their employer when they are bound by a duty to benefit their principal and to disclose facts relating to their principal’s business.<sup>34</sup>

## Conclusion

The corporate opportunity doctrine is designed to ensure that fiduciaries are mindful of their duties of loyalty and good faith when dealing in the business of their principals. The focus should be on the nature of the opportunity; faithless agents should not be able to reduce or escape liability through

collusion over the offering of the opportunity. In addition, the rule should apply to employees to the extent the opportunity at issue is within the scope of their agency. ■



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## ENDNOTES

1. *Production Finishing Corp v Shields*, 158 Mich App 479; 405 NW2d 171 (1986).
2. *Id.*
3. *Rapistan Corp v Michaels*, 203 Mich App 301; 511 NW2d 918 (1994).
4. *Production Finishing*, 158 Mich App at 483.
5. *Id.* at 484.
6. *Id.* at 485.
7. *Id.* at 485–486, quoting 18B Am Jur 2d, Corporations, § 1770, pp 623–624.
8. *Id.* at 489, quoting *Energy Resources Corp, Inc v Porter*, 14 Mass App Ct 296, 300–301; 438 NE2d 391(1982).
9. *Id.* at 489–490, quoting Brudney & Clark, *A New Look at Corporate Opportunities*, 94 Harv L Rev 997, 1021 (1981).
10. *Rapistan*, 203 Mich App at 306–307, quoting *Guth v Loft, Inc*, 23 Del Ch 255; 5 A2d 503 (1939).
11. *Id.*
12. *Id.*
13. *Id.* at 309.
14. *Id.* at 310.
15. *Id.* at 307.
16. *Id.* at 309–310.
17. *BSA Mull v Garfield Investment Co*, unpublished per curiam opinion of the Court of Appeals, issued September 30, 2014 (Docket No. 310989), p 17; *Sargent Docks and Terminal v Webber*, unpublished opinion of the Saginaw County Circuit Court, issued August 7, 2015 (Docket No. 11-014229-CB), p 15.
18. *Corporate Auto Resource Specialists v Pruitt*, unpublished opinion of the Oakland County Circuit Court, issued August 31, 2016 (Docket No. 16-152738-CB), p 8.
19. *Rapistan*, 203 Mich App at 308.
20. *Guth*, 23 Del Ch at 273.
21. *Broz v Cellular Info Sys*, 673 A2d 148, 155 (Del, 1996).
22. *Guth*, 23 Del Ch at 273–274.
23. *Id.* at 277.
24. *Rapistan*, 203 Mich App at 307.
25. *Id.*
26. *Production Finishing*, 158 Mich App at 490.
27. See, e.g., *DSC Communications Corp v Next Level Communications*, 107 F3d 322, 326 (CA 5, 1997) (applying Texas law).
28. *Corporate Auto Resource*, unpub op at 9.
29. *Production Finishing*, 158 Mich App at 486.
30. *Id.*, quoting *Michigan Crown Fender Co v Welch*, 211 Mich 148, 159; 178 NW 684 (1920).
31. *Central Cartage Co v Fewless*, 232 Mich App 517, 524; 591 NW2d 422 (1998).
32. *Id.* at 526.
33. See, e.g., *Raymond James & Assoc v Leonard & Co*, 411 F Supp 2d 689, 699 (ED Mich, 2006).
34. *Production Finishing*, 158 Mich App at 486.