Corporations: Fiduciary Duties

• Duty of Care
  o Directors & Officers are liable to their corporation from their lack of diligence/care.
    ▶ Must meet the standard of the ordinarily prudent business person in similar circumstances
    ▶ Must make a reasonable investigation and honestly believe the action is in the best interests of the corporation
  o Business Judgment Rule (BJR)
    ▶ **An informed decision**: Management must conduct a reasonable investigation
      ▪ Outside experts – information, reports and opinions
      ▪ Director as expert – within field of knowledge
Business Judgment Rule (continued)

- **No conflict of interest**: Managers may not personally benefit from transaction, except as the natural fruits of the action taken benefits the corporation (e.g., as shareholder)
- **Rational basis for action**: The decision taken must have a reasonable connection to the facts of the investigation
  - The “best” or “optimal” decision is not required

**Brehm v. Eisner, 906 A.2d 27**: "Our law presumes that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."
Knowing Violation of Criminal Statute

- The BJR’s presumption of propriety does not extend to knowing violations
- Derivative Lawsuit Requirements:
  - Must show directors knowingly violated the criminal statute, and
  - The corporation suffered a net loss as a result

Sample BJR Question
The Business Judgment Rule is a rule that immunizes corporate:
a. Management from liability for actions taken in good faith but not within the power of the corporation or the authority of management to make.
b. Management from liability for actions taken in good faith and are within both the power of the corporation and the authority of management to make.
c. Shareholders from liability for actions taken in good faith and are within both the power of the corporation and the authority of shareholders to make.
d. Shareholders from liability for actions taken in good faith but are not within the power of the corporation or the authority of shareholders to make.
Corporations: Fiduciary Duties

- **Director’s Duty of Loyalty**
  - Directors/officers owe the utmost fidelity/loyalty
    - Focus is on motives, purposes, and goals
    - Placing the interests of the corporation first
  - **Conflicts of Interest – Dealing with the corporation to your benefit.** MBCA – allows, so long as:
    - Transaction was approved by a majority of informed, disinterested directors,
    - Transaction approved by majority of shares held by informed, disinterested shareholders, or
    - Transaction is intrinsically fair
      - Fairness: reasonable persons in arms length transaction
Corporations: Fiduciary Duties

- **Mismanagement**
  - Action against management belongs to the corporation
  - Creditors may proceed against closely held corporation

- **Fiduciary Duty to Disclose**
  - Directors owe shareholders duty of complete candor
  - Shareholders are entitled to damages “logically and reasonably related” to the failure to disclose

“But this duty to disclose is not a general duty to disclose everything the director knows about transactions in which the corporation is involved. Rather, the director disclosure cases decided in Delaware courts have implicated circumstances in which the director is personally engaged in transactions harmful to the corporation, but beneficial to the director.” *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 922 A.2d 1169, 1194
Corporations: Fiduciary Duties

• Usurpation of Corporate Opportunity – Directors/officers may not steal opportunities that rightfully belong to the corporation, but:
  o Opportunity must come to the director in their corporate capacity,
    ▪ Opportunities received at office
    ▪ Upper management is nearly always in capacity, even away from office
  o Opportunity must relate to an existing or prospective corporate activity, and
    ▪ Interest or Expectancy: An existing interest or expectancy growing out of an existing right
    ▪ Line of Business: Relation of opportunity to line of business in which corporation is engaged
Corporations: Fiduciary Duties

- **Usurpation of Corporate Opportunity (Cont’d)** –
  - Corporation must be financially able to take advantage of the opportunity
    - Managers/Directors are expected to make good faith effort in locating corporate financing
    - But, managers/directors are not expected, or required to loan personal funds to corporation

  **Note:** Directors/Officers are free to exploit opportunities which the corporation has rejected.

- **Forbidden Profits**
  - No secret kickbacks, commissions, or rewards
  - Director/Officer has affirmative duty to prevent fraud
Duty Not To Compete
- May not compete with corporation during employment
  - Non compete agreement is not required
- May inform clients of intent to leave
  - But may not solicit clients
  - Usually it’s okay to solicit clients after the employee resigns, unless the customer list is confidential or a trade secret
- What’s a trade secret?
  - Extent to which information is generally known
  - Extent to which it is known by employees
  - Extent of measures taken to keep the information secret
  - Cost in developing the information
Corporations: Fiduciary Duties

- Controlling Stockholders Fiduciary Obligations
  - Some courts impose a fiduciary duty on majority stockholders
    - The controlling stockholder has a duty to be impartial
    - The transaction must be intrinsically fair
  - Example:
    - The Freeze Out – Oppression of Minority Stockholders
      - Controlling stockholder has corporation pay them a high salary while refusing to declare dividends
    - Going private
  - Where statutes allow freeze-out they normally balance with a right of appraisal.
  - In a closed corporation the shareholders owe one another duties similar to those owed by partners