

Self-Dealing By Officers or Directors of a Corporation

by Dan Brecher on October 4, 2012

Corporations are owned by their shareholders, managed by their directors and operated by their officers. On occasion, directors or officers have used their positions of trust to take advantage of opportunities that should have gone to their corporations. Unless done with the prior knowledge and authorization of their corporation, an officer or director who seizes such an opportunity has breached fiduciary duties owed to his corporation and its shareholders. Penalties, including punitive damages, can be imposed upon those officers or directors who have not acted with proper loyalty or who acted unlawfully in the transaction.

We represent a shareholder in a federal action against an officer/director who was the sole signatory on the corporation's bank account and misused that position by refusing to pay our client moneys owed for services, and then took personal advantage of our client's resultant lack of funds by issuing shares of the corporation to his own separate company at an artificially low price, thereby reducing our client from a controlling 51% ownership down to 9% ownership. These acts constitute examples of breaches of fiduciary duties owed by an officer of a corporation. The court denied the defendant's motion to dismiss the complaint, and the matter is set for a jury trial.

A jury could find that such acts should result not only in an award of damages based upon the actual dollar amount of the lost value of the misappropriated securities, but could also award punitive damages, if the jury determines that the wayward officer's acts are illegal or outrageous, which is what we allege.

Although such claims can go to the jury for determination in New Jersey and New York, there is a difference between how such cases are dealt with in the courts in Delaware, where many corporations are formed. Even New York and New Jersey courts may be required to apply Delaware law, if the corporate agreements state that only Delaware law should be applied. Under Delaware law, claims against officers or directors of Delaware corporations for breach of fiduciary duties are not tried to a jury unless a specific statute authorizes a jury trial.

Another example of a breach of fiduciary duties by an officer or director occurs when the duty of undivided loyalty to the corporation is breached and the officer or director takes for his own advantage and profit an opportunity that rightfully belongs to the corporation. This assumes that the opportunity is in the corporation's line of business and the corporation has an interest or expectancy in pursuing such an opportunity. If the opportunity is kept hidden from the corporation by the officer or director, this would further support the claim of breach of fiduciary duty. A defense to the claim would exist if the corporation consented to the transaction being done away from it.

Courts will look to the agreements and other writings between the corporation and the defendant to determine whether or not there was informed consent or prior authorization for the officer or director to take personal advantage of the opportunity. If a corporate opportunity has been usurped, other remedies in addition to traditional money damages may be awarded, such as the imposition of a constructive trust in favor of the corporation upon the property acquired.

If you have any questions about the obligations of officers and directors to their corporations and to shareholders, or would like to discuss this topic, please contact me, Dan Brecher, or the Scarinci Hollenbeck attorney with whom you work.