

Look before you leap

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Perhaps business relations with your colleagues are not as smooth now as when you formed your small business. You and your colleagues have differing goals and objectives about how the business should be run and the direction that the business should take. You are considering looking for new opportunities and have heard about a new deal in which you may be interested but which you doubt that your colleagues will want to pursue. Can you go after the new deal yourself? Can you team up with another business associate from a different company? Do you have any obligations to your current business colleagues?

The Virginia Supreme Court has made clear in a line of decisions stretching back more than 60 years that officers and directors of corporations owe a fiduciary duty to the corporation and to the stockholders of the corporation. This fiduciary duty is the same duty that a trustee owes to the beneficiary of a trust and is among the most important of all duties that one businessperson can owe to another. The Court has stated this rule is an “unbending” one and requires that a corporate officer or director “act in the utmost good faith, and this good faith forbids placing himself in a position where his individual interest clashes with his duty to his corporation.” The Court has also noted that this fiduciary duty applies with equal force to “agents, partners, guardians, executors and administrators, [and] directors and managing officers of corporations” as well as to the trustee of a trust.

Moreover, when the actions of a businessperson are challenged by those to whom he or she owes a fiduciary duty, the businessperson also has the burden of proving that his or her conduct has been undertaken in good faith and is fair. This burden of proof is an exception to the business judgment rule in Virginia which may otherwise limit the power of a court to review matters relating to the internal management of the corporate affairs of the business.

Fiduciary duty challenges can arise in a variety of situations. Does your corporation need to purchase a product or service that is offered by another business in which you have an interest? A resulting contract that is unfair to the purchasing company may be subject to challenge because you have benefited yourself through your other business at the expense of the purchasing company.

Are you paying salaries or other compensation to yourself or other employees in your company that other stockholders view as disproportionate or excessive? If so, your actions may be subject to challenge in court because you have not acted fairly and in good faith toward your fellow stockholders.

Do you want to merge your company or sell its assets to another firm when others in your company do not? You have the right to resign your position and pursue other opportunities in competition with your former business (in the absence of any contract not to compete), but that right is not unlimited. The strong public policy in the commonwealth favoring free competition will be balanced with the importance of the integrity and fairness inherent in the relationship between a company and its officers, directors and key employees.

Have you become aware of a corporate opportunity that you want to pursue but which you have not disclosed to your colleagues? If you elect to leave your company to start a new business so that you can pursue that opportunity, you may find yourself subject to challenge because you have breached your fiduciary duty by diverting a corporate business opportunity to yourself for personal gain rather than first offering it to your corporation.

Each of the above situations has arisen in one or more cases that have been heard by the Virginia

Supreme Court. The principle of fiduciary duty is alive and well in Virginia, and any businessperson who ignores his or her duty does so at his or her peril. Any businessperson challenged with a breach of fiduciary duty may also find that he or she must bear the burden of proving that his or her actions were undertaken in good faith and in a manner that was fair to the enterprise. If you find yourself in a situation where you are not sure if you owe a duty to a business colleague or to your company, look before you leap because the consequences of an uninformed decision can be severe.

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