Usurpation of corporate opportunities

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The corporate opportunity doctrine precludes fiduciaries from "divert[ing] and exploit[ing] for their own benefit any opportunity that should be deemed an asset of the corporation." *O'Mahony v. Whiston*, No. 652621/2014, 2019 WL 4899030, at *6 (N.Y. Co. Oct. 4, 2019) (citing *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 147 A.D.2d 241, 246 (1st Dep't 1989)). The doctrine is premised on the notion that a corporate officer or director may not personally profit at the expense of the corporation. *See Troffa v. Troffa*, No. 6095102016, 2022 WL 3140457, at *6 (Suffolk Co. Aug. 2, 2022). When a fiduciary usurps or diverts a corporate opportunity, "he may be held accountable for the fruits of his wrongdoing." *Sheiffer v. Petry Holding*, No. 601792/2004, 2005 WL 6578258 (N.Y. Co. 2005).

New York courts generally use two non-exclusive tests to determine whether the opportunity at issue was a corporate opportunity: (1) the tangible expectancy test and (2) the line of business test. While these tests help assess what constitutes a "corporate opportunity," some courts take a more general approach assessing all relevant factors. Recent Commercial Division cases applying these tests are discussed below.

Tangible expectancy test

When conducting a "corporate opportunity" analyses, many New York courts utilize the tangible expectancy test, either as a standalone test or in conjunction with the line of business test. Under the tangible expectancy test, the court will look at whether the corporation in fact had a tangible expectation of exploiting the alleged diverted opportunity for itself. "Tangible expectancy" is "much less tenable than ownership" but "more certain than a desire or a hope." *Alexander & Alexander*, 147 A.D.2d at 247-48.

In *TMT Entertainment Group v. Gasparro*, although the court did not specifically state it was applying the tangible expectancy test, Justice Andrew Borrok of the New York County Commercial Division found the plaintiff could have expected to receive fees the defendant took for himself and thus the plaintiff sufficiently alleged usurpation of a corporate opportunity. No. 652970/2018, 2019 WL 1044197, at *2 (N.Y. Co. March 4, 2019). The plaintiff, TMT Entertainment Group (TMT), hired defendant Michael Gasparro as a talent manager and producer. A fiduciary relationship allegedly existed between the parties, as Gasparro had a duty to act and give advice for

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TMT's benefit on matters within the scope of their relationship. Pursuant to the terms of his employment, Gasparro was to remit to TMT any fees he received in connection with his role as a producer. Gasparro allegedly informed TMT of two projects on which he would work as a producer—the "Kalief Project" and the "Trayvon Project"—and subsequently entered into agreements with other parties to provide production services for the projects. Gasparro reportedly told TMT he received $40,000 less in producer's fees than he actually received for the Kalief Project and also claimed he was exclusively entitled to the Trayvon Project fees. The court found TMT sufficiently alleged that the producer's fees from the two projects were assets of the plaintiff management company and that Gasparro diverted those assets to himself.

In contrast, following a bench trial in *Shatz v. Chertok*, Justice Jennifer Schecter of the New York County Commercial Division held that plaintiff Shatz did not have a tangible expectancy in an investment opportunity that defendant Chertok took for another LLC he managed. No. 655620/2018, 2022 WL 4357085, at *1 (N.Y. Co. Sept. 20, 2022). Chertok was the managing member of Vast Ventures VI LLC (Vast 6) and Shatz was its non-managing member. The Vast 6 Operating Agreement gave Chertok "sole and absolute discretion" to select which investments Vast 6 would make. Chertok was also the manager of another investment LLC, Vast Ventures V LLC (Vast 5). In 2013, Chertok and Shatz agreed to invest, through Vast 6, in Ripple Labs, Inc.'s (Ripple) Series A. However, the Series A round was postponed. Later that year, Ripple approached Chertok to invest in its convertible note, which Chertok did through Vast 5. Shatz alleged that Chertok should have brought the convertible note opportunity to Vast 6 and that Vast 6's involvement with the Series A created a "tangible expectancy" in future Ripple investment opportunities. Shatz further alleged that Chertok usurped this opportunity by investing in the convertible note through Vast 5.

Justice Schecter held that Vast 6's potential investment in Ripple during the Series A round did not create a tangible expectation in the later loan because that later loan, a convertible note, was materially different and thus a new opportunity. That Ripple decided to issue a convertible note and delay its Series A round by a year was "proof enough that this [was] not a mere matter of semantics." Because Chertok had no duty to acquire a particular opportunity and had sole and absolute discretion where to invest, neither Shatz nor Vast 6 could claim a tangible expectancy in a prospective opportunity until if and when that opportunity was brought to them. Had Chertok not even told Shatz about the Series A or the convertible note, Shatz still would not have a claim. In contrast, had Ripple offered Chertok an investment opportunity on terms substantially similar to the Series A round and shortly after the raise was postponed, Shatz and Vast 6 would have had a tangible expectation in that opportunity which Chertok could not have diverted to Vast 5.

Similarly in *Troffa v. Troffa*, Justice Jerry Garguilo of the Suffolk County Commercial Division applied the tangible expectancy test when denying the plaintiffs' motion for partial summary judgment finding, among other things, that although the plaintiffs made a prima facie showing of a corporate opportunity and that the defendants breached their fiduciary duty, the defendants raised a triable issue of fact about whether there was a tangible expectancy. 2022 WL 3140457, at *4. In *Troffa*, plaintiff Jonathan Troffa, a 50% shareholder in the nominal defendant corporation, alleged that his father, Joseph Troffa and also a 50% shareholder in the corporation, usurped corporate opportunities by purchasing a 1.78-acre parcel of real property (the Compost Yard) in his name by paying the balance on the purchase price. Jonathan claimed that he was unaware the rent the corporation paid would be applied as a down payment for the purchase of the Compost Yard and that Joseph eventually purchased the property in his own name. Jonathan alleged that the right to purchase the Compost Yard was an asset of the corporation and Joseph usurped that opportunity. Justice Garguilo found that Joseph raised a triable issue of fact based on Joseph's claim that the corporation had no expectation of owning the property as the corporation had never purchased any of the other five properties it had rented and on which it did business. Additionally, under the lease, the corporation paid rent for the use and occupancy of the Compost Yard prior to the closing. Therefore, there was a triable issue of fact whether the corporation had an expectation to purchase the property.

Line of business test

Under the line of business test, a "corporate opportunity" is an opportunity that is the same as, necessary for, or essential to the line of business of the corporation. *See Alexander & Alexander*, 147 A.D.2d at 248. This test looks at whether the consequences of the deprivation threaten the viability of the corporation. When New York courts employ this test, they often do so in conjunction with the tangible expectancy test.

In *2 Girls ACCYS v. Larrea*, for example, the plaintiff company alleged the defendants, whom the company employed, diverted the company's suppliers and customers for their own competing business. No. 655786/2018, 2020 WL 5439527, at *1 (N.Y. Co. Sept. 9, 2020). The *2 Girls* court utilized a combination of both the line of business test and the tangible expectancy test in assessing whether a corporate opportunity existed. Justice Andrea Masley of the New York County Commercial Division noted that, to state a claim for diversion of corporate opportunities, plaintiffs must allege both a tangible expectancy in the business opportunity and that the diversion of the opportunity would threaten the viability of the company. Here, the company's sole allegation of possible diversion was that after resigning, one defendant failed to inform the company that Walmart had been prepared to place a substantial order. As a result of this failure, the order did not go through. The company alleged the lost order was more than a mere hope for business with Walmart. Justice Masley held that, not only did the company fail to show how the potential sale was diverted elsewhere, it failed to show how the loss of this potential sale threatened the company's viability. Therefore, the court dismissed the claim for diversion of a corporate opportunity.

All relevant factors approach

Some courts use neither the tangible expectancy nor the line of business test, but rather take a broader approach and assess all relevant factors as a whole.

In *Sheiffer v. Petry Holding Inc.*, Judge Charles Ramos of the New York County Commercial Division found that defendant Petry sufficiently plead in its counterclaim that plaintiff Sheiffer usurped corporate opportunities and assets belonging to Petry. 2005 WL 6578258. Sheiffer, the Chairman and Chief Financial Officer of Petry, allegedly willfully failed to inform Petry's Board of Directors that its competitor's parent company was interested in acquiring or merging with Petry. This was seemingly because Sheiffer strongly supported the efforts of another company, on whose board Sheiffer then served, to acquire Petry for materially less consideration than others were willing to pay. In assessing these factors, and while accepting as true the allegations of the counterclaim, the court held that the counterclaim adequately plead that Sheiffer usurped an opportunity belonging to Petry.

Consent

Even if a court finds a venture constitutes a corporate opportunity, a party will not have a viable claim for usurpation of a corporate opportunity if there was consent. In *O'Mahony*, the parties formed a corporation (Dubcork) to own a bar named Smithfield. 2019 WL 4899030, at *1. Shortly after opening, Dubcork entered into a $1.9 million settlement agreement with its landlord to close Smithfield so the property could be developed. Unbeknownst to the plaintiffs, the defendants had formed a new corporation (Moxy) to open a new bar, also called Smithfield. The plaintiffs were not offered the opportunity to invest in Moxy, and Dubcork was not offered the opportunity to own the new bar despite the fact that Dubcork's settlement helped fund the new bar. Defendants advertised that Smithfield would be opening at a smaller location, misrepresented to plaintiffs that the Dubcork settlement had not yet been received (although it had been and its funds were used to open the new bar), and continued to use the original Smithfield's website so that its patrons would be routed to the new bar.

The plaintiffs argued the new bar was a mere continuation of the old bar and so qualified as a corporate opportunity. Justice Jennifer Schecter of the New York County Commercial Division denied summary judgment, finding a material question of fact existed as to how much the plaintiffs knew about the new bar and when they knew it. Had they known defendants were intending to open a new bar with the settlement funds, then even if the new bar were a corporate opportunity, the plaintiffs would have waived any objection to it: "Plaintiffs cannot obtain the benefit of the [n]ew [b]ar without investing

and taking any risk if they knew of the opportunity but never objected to being excluded. It would be inequitable to allow them to piggyback on the Individual Defendants' efforts under such circumstances."

Conclusion

Absent consent, fiduciaries cannot divert or exploit for their own benefit an opportunity that otherwise would be deemed an asset of their corporation. What constitutes a corporate opportunity is not always clear. As discussed above, courts generally apply the tangible expectancy test, a combination of both the tangible expectancy test and the "line of business" test, or look at all relevant factors as a whole when making this determination. To avoid exposure to a claim for usurpation of a corporate opportunity, a fiduciary would be well advised to seek consent of the corporate entity before capitalizing on any transaction that may belong to the corporation.

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