

## Identifying Breaches of Fiduciary Duties

By Charles E. Hamilton, III, Esq.,  
Lamothe & Hamilton, P.L.C., New Orleans, LA  
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A claim for breach of fiduciary duty can arise in an enormously broad range of settings and is a relatively simple claim to assert. It should be considered in almost any formal relationship in which a relationship of trust is perceived to have arisen. The attorneys at Lamothe & Hamilton are available to consult concerning the issues discussed in this paper.

The claim has five principal elements:

1. Proof of the existence of a duty,
2. Proof that it was owed to the complaining party,
3. Breach of the duty,
4. Causation, and
5. Injury

It has been suggested that the concept of fiduciary duty will become increasingly important in modern economies due to the popularity and growing use of non-traditional business alliances, such as joint ventures. A strong concept of fiduciary duty can provide important incentives for people and entities to enter into such alliances by reducing the risks from the conduct of other parties to which they would be otherwise be exposed.

This paper identifies seven types of common relationships in which breach of fiduciary duties have been found to arise. However, this list is by no means exhaustive and readers of this paper should not rely on this paper as counseling or rejecting claims in any individual situation. Fiduciary duties have been found to arise in an extraordinarily broad range of circumstances, and the results reached by the courts are sometimes contradictory. Thus, no effort has been made to be exhaustive within the confines of this brief paper.

The principles discussed in this paper can provide a beginning point for client discussions of fiduciary duty claims with an attorney retained especially for the purpose. They merely suggest the broad range of possibilities that exists.

A fiduciary has been defined as a person who undertakes to act in the interest of another person. The principal characteristic of a fiduciary relationship is the trust and confidence that one person places in another.

Where it exists, the relationship is usually said to give rise to three principal duties. The first is a **duty of loyalty** -- a duty to act for and on behalf of the person or

entity to whom the duty is owed, and not to take advantage of, or injure, him or it. The second is a **duty of obedience** -- the duty to act within the bounds of the authority or trust that has been extended. The third is a **duty of care** -- the duty to act prudently. Sometimes a **duty of disclosure** of all material information is said to be a fourth duty; at the least, it is a necessary corollary of the other three duties and this duty extends to the disclosure by the fiduciary of material facts.

The threshold issue in litigation asserting a breach of fiduciary duty is to determine whether a fiduciary relationship has arisen in the first place, and to determine to whom the duty is owed. In situations involving multiple actors, or entities, this issue can call for careful reflection, and the outcome can vary widely according to the specific facts involved.

### 1. The Corporate Context:

In the corporate context, an appropriate beginning point is to examine with an attorney the applicable corporation laws, the articles and bylaws of the company, its board resolutions and any employment contracts or other agreements that may fix the duties of the officer, agent, director or employee involved.

Corporate directors are uniformly regarded as fiduciaries of the corporation, obligated to act in good faith and in a manner reasonably believed to be in the best interest of the corporation. Actions taken in bad faith, or in less than good faith, are generally actionable. State laws typically state the standards of liability for directors, which are grounded in traditional common-law concepts. State law also states the circumstances under which a director can expect to rely on information from, and reports of, officers, employees, as well as attorneys, accountants and other professionals. It is worth noting that the designation of such professionals can vary from state to state. For example, Louisiana expressly includes petroleum reservoir engineers within the list of such persons.

On the other hand, a mere corporate agent or employee whose duties do not involve the discretion to act for the corporation is not generally regarded as having the fiduciary duties of an officer but may have more limited fiduciary duties under general principles of agency law. The title assigned by the corporation or the employer is not controlling; the test is a functional one. Whether or not fiduciary duties are owed will depend in large measure on the nature of the duties assigned. But it has been suggested that a person designated as an officer by the board of directors should be presumed to be empowered to exercise discretion in the handling of corporate affairs and be subject to the fiduciary duties attaching to an officer.

The exact scope, extent and nature of the particular fiduciary duty involved is important. Where an individual wears multiple "hats" within an organization, it is useful to consider the capacity in which he or she was acting. Some state laws devote different sections to the definition of the fiduciary duties of officers and of directors, even though they typically use similar language ("good faith", "care" and "best interests of the

corporation”) to describe the duties of each.<sup>1</sup> Under the local law, the duty of loyalty may not vary according to the level of discretion assigned to the officer, but the standard of care, which is that exercised by an ordinarily prudent person, can be affected by the discretion assigned.

An officer’s greater familiarity with the organization’s affairs may result in a greater potential for liability. In an early leading case in this area, the president and directors of a corporation were charged with responsibility for employee thefts from the corporation. The president was found to owe a higher standard of care to the corporation because he had daily contact with the company’s deposit ledger and was therefore in a better position to detect the theft. This element of greater familiarity with the daily affairs of the corporation normally warrants the directors relying upon the officers and other employees of the corporation who are reasonably believed to be competent in their functions served or the information or opinions that they give.

Generally speaking, corporate officers and directors do not owe fiduciary duties to corporate creditors because the creditor/debtor relationship is generally not based on trust but rather on arm’s length bargaining in the marketplace. However, when the company becomes insolvent or nearly insolvent, the directors and officers can find themselves subjected to the argument that they owe fiduciary duties to corporate creditors, as a part of the “community of interests” that sustains the corporation whenever the directors operate the corporation “in the vicinity of insolvency”.

Shareholders in a close corporation may owe fiduciary duties of loyalty to each other and to the corporation similar to those owed by partners in a partnership. Those duties may be affected by the relative shareholdings of the owners involved. A receiver or liquidator of a corporation is assigned fiduciary duties under local statutes regulating the handling and disposition of corporate assets in such situations. For example, one famous Louisiana case holds that it was a breach of a fiduciary duty for a corporate liquidator knowingly to sell property for an inadequate consideration.

Each state has very particular rules involving the right of an employee to compete with a former employer and places very specific limits on the employer’s right to limit post-termination competition with the employer. Those rules and their application are beyond the scope of this paper. The attorneys at Lamothe & Hamilton are available to consult concerning these issues.

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<sup>1</sup> For example, Louisiana’s Business Corporations Law, at La. R.S. 12:91(A), defines the duty of care (of corporate officers and directors) as a duty to:

“discharge the duties of their respective positions in good faith and with that diligence, care judgment and skill which ordinary prudent men would exercise under similar circumstances in like positions.”

The duties of directors and officers of nonprofit corporations are typically stated in similar terms.

## **2. Partnerships and Joint Ventures:**

The Uniform Partnership Act has been adopted in virtually every state. Under it, a partner owes fiduciary duties to the partnership that he or she is part of. These duties typically include obligations act in good faith and with integrity, as well as a duty to disclose. This is different from the duty imposed on partners under many states' laws to provide information when requested and involves an additional affirmative duty to disclose material information. The determination of what is material information will vary according to the context; it is generally information that would be expected to induce action or forbearance by another. Several factors will influence this determination, such as the sophistication of the parties, the degree of access to information and the level of involvement of the complaining partner in partnership affairs. The specific duties of a partner may be the subject of particular local legislation, so it is always important to review the applicable local statutes with counsel. It is worth noting that some commentators believe the fiduciary duties of partners should be somewhat higher than those of shareholders in close corporation by reason of the partners' greater power to bind the partnership and dissolve the partnership.

The right of a former partner to compete with his other partners or with the partnership after his relationship has terminated is subject to special rules under state law and is beyond the scope of this paper. The attorneys at Lamothe & Hamilton are available to consult concerning these issues.

Similarly, co-venturers in a joint venture owe a fiduciary duty to each other. The scope of fiduciary duties within joint ventures may be narrower than those in partnerships since the objective of joint ventures are ordinarily more limited than those of partnerships and tend to be confined to specific undertakings.

## **3. Family Relationships:**

A fiduciary relationship can exist between a parent and a child. For example, a custodial parent acts as a fiduciary when he or she receives child support payments. However, courts are generally reluctant to infer agency relationships between family members, and find an agency/fiduciary relationship only where the agent acts on behalf of his principal with the latter's express, implied or, apparent authority.

## **4. Financial Advisors and Brokers:**

A fiduciary relationship has been found to exist between a financial advisor and a client. The issue of whether a broker owes a fiduciary duty to his customer is frequently and hotly disputed in litigation and in arbitration and different results have been reached in varying circumstances. Where a broker does not exercise discretionary control over trading in his customer's account, the duty, absent special circumstances, may be a narrow one, limited to the faithful execution of transactions ordered by the customer.

## **5. Insurers and their Insureds:**

In some states, a fiduciary relationship has been found to exist between an insurer and his insured. *Cason v. Texaco, Inc.*, 621 F.Supp. 1518, 1526 n. 21 (M.D. La. 1985). Other states deny the existence of a fiduciary relationship and characterize it, instead, as quasi-fiduciary or confidential.

## **6. Contractual Relationships:**

A fiduciary relationship may exist between an experienced contractor, who has negotiated a cost-plus contract, and an inexperienced homeowner, where the terms of the building contract support such a conclusion. A homeowner's association may owe a fiduciary duty to its members, at least in dealing with an individual homeowner's unit. But parties to an ordinary contract do not generally owe each other fiduciary duties. Absent special circumstances, a contract only gives rise to an obligation to perform the obligations created in it. Thus, an employer-employee relationship may not create a fiduciary responsibility of the employer towards the employee; special circumstances such as the imparting of confidential information may impose a fiduciary duty on an employee.

There are many contractual situations, in which one party may feel a strong sense of dependence on another, that do not necessarily give rise to fiduciary relationships. Thus, the general rule is that the parties to a manufacturer/dealer agreement are not fiduciaries of each other because such relationships typically arise from arm's length commercial transactions. See, *Delta Truck & Tractor, Inc. v. J.I. Case Co.*, 975 F.2d 1192, 1205 (5<sup>th</sup> Cir. 1992); *Hunter Mining Laboratories, Inc. v. Management Assistance, Inc.*, 104 Nev. 568, 763 P. 2d 350 (Sup. Ct. Nev. 1988) (dealers did not have a duty to act primarily for the benefit of the manufacturer in the sale of computers and software; the typical provisions of a manufacturer/distributor agreement do not create the type of control that creates a question of fact regarding the existence of an agency).

## **7. Informal or De Facto Relationships:**

The concept of a *de facto*, or informal, fiduciary relationship seems to be rapidly evolving in the case law of some states. Generally, for example, although there is no obligation to make full disclosure to a party on the other side of a bargaining table, some cases have held that one cannot present a misleading half-truth where he undertakes to speak. See, *Manchester Mfg. Acquisitions v. Sears, Roebuck*, 802 F.Supp. 595 (D.N.H. 1992) (officers of company bought company after learning of Sears' intention to sell the company; although there was no formal fiduciary relationship between the parties, Sears told them sale would not affect the company's business with Sears; Sears terminated the company post-sale; officers stated a claim against Sears for negligent non-disclosure).

The evolving case law seems to raise the possibility that fiduciary (or quasi-fiduciary) duties to disclose can be found in some jurisdictions where: (1) one party possesses superior knowledge, not readily available to the other, and knows that the other

is acting on mistaken knowledge, (2) where one acquires information that renders misleading other information that was given earlier; (3) dominance or superiority of knowledge, or a commitment to act for another's benefit, on one side, and a vulnerability, inferior knowledge and reposing of trust, on the other hand.<sup>2</sup>

In this area, uncertainty and the fear of liability has given rise to particularized state legislation which should be reviewed. For example, La. R.S. 6:1124 governs banking relationships and provides in part that:

“No financial institution or officer or employee thereof shall be deemed or implied to be acting as a fiduciary, or have a fiduciary obligation or responsibility to customers or to third parties other than shareholders of the institution, unless there is a written agency or trust agreement under which the financial institution specifically agrees to act and perform in the capacity of a fiduciary.”

Once a fiduciary duty has been identified, it is important to determine where that duty begins and to whom it extends. Thus, someone who has contracted with a corporation may owe duties to the corporate entity but they may not run to persons or entities outside the corporation that contract with the corporation. Corporate officers, employees and agents do not generally owe duties to third parties and are not generally held liable to third-parties for negligence, mismanagement or omissions in handling the corporate affairs. Similarly, the shareholders of a corporation do not ordinarily owe fiduciary duties to a creditor of the company. But note the discussion above concerning operation of a corporation in the vicinity of insolvency.

### **Conclusion**

In each situation, the relationship at issue must be carefully considered, in consultation with an attorney retained for the purpose, in light of the nature of a true fiduciary relationship and the nature and scope of the parties' undertakings and mutual expectations. The outcome of these cases is highly dependent upon the facts of each case and the facts and the law should be carefully reviewed with an attorney retained for the purpose. The attorneys at Lamothe & Hamilton are available to consult concerning these issues.

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<sup>2</sup> See, for example, *Knauf Fiber Glass, GmbH v. Stein*, 615 N.E. 2d 115 (Ind. App. 1993) *aff'd. in part, vacated in part* 622 N. E. 2d 1163 (Ind. 1993) *rehearing denied* (August 16, 1994) (Court found a special relationship between a shipper and the carrier of its products; shipper promised carrier it would give substantial business to carrier if it incurred expenses to expand its fleet of trucks and then reneged on the promise, causing the failure of carrier); *Pearson v. Simmons Precision Products*, 624 A.2d 1134 (Vt. 1993)(failure, in response to an inquiry, to tell a potential employee that his position may be liquidated); *Brass v. American Film Technologies*, 987 F.2d 142, 150-51 (2d Cir. 1993)(purchaser of warrants to by stock of company was not told that the underlying stock was part of a private placement that could not be publicly traded for two years was held to have stated a claim); but see, *Herrin v. The Medical Protective Company*, 89 S. W. 3d 301 (Ct. App. Tex. 2002) (informal fiduciary relationships are rarely recognized).