

BREACH OF FIDUCIARY DUTY IN BUSINESS LITIGATION

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Advantages to the Plaintiff in Establishing the Fiduciary Relationship

Useful jury instructions. Defendant must show that:

- Transaction was fair to Plaintiff
- Defendant placed Plaintiff's interests ahead of his own, without any conflict of interest
- Defendant fully and fairly disclosed all important information to Plaintiff concerning the transaction

Proving Damages Becomes Easier

- ◆ Fee disgorgement
- ◆ Constructive Trust

Fiduciary Litigation in Texas: Three Key Steps

- **Identifying the Defendant as a Fiduciary**
- **Defining the Fiduciary Duties Owed**
- **Proving Breach and Damages**

Defining the Relationship: What makes a Fiduciary?

- Some relationships are “fiduciary” as a matter of law
- The other fiduciary relationships stem from either **formal relationships** or **informal relationships**

Formal Fiduciary Relationships

Some relationships yield fiduciary obligations purely as a matter of law, for determination by the court. *Meyer v. Cathey*, 167 S.W.3d 327, 300 (Tex. 2005).

Trustee → Beneficiary

Directors → Corporation

Licensee → Licensor

Employees → Corporation

Attorney → Client

Agent → Principal

Partners → Partnership + Partners

Pension Plan Advisors (ERISA Fiduciaries)

→ Pension Plan

Joint Venturers

Informal Fiduciary Relationships

Many relationships do not create fiduciary obligations as a matter of *law*, forcing the plaintiff to prove it as a matter of *fact*.

What facts produce informal fiduciary relationships?

- **Key:** The fiduciary relationship revolves around **trust** and **confidence**
- Where the plaintiff **relies upon** and **trusts** the defendant fiduciary
- Defendant acted in a position of dominance over the plaintiff
- Many close business relationships, but the fiduciary relationship must exist prior to and apart from the transaction in question
- Subjective trust alone is insufficient, must be supported by objective facts

Admissions to Obtain (or Avoid) to Establish Informal Fiduciary Relationship

- Defendant was an expert vis-à-vis the Plaintiff, who paid for that expertise
- Defendant understood that he was to place the Plaintiff's interests ahead of his own
- Defendant understood that the Plaintiff trusted and relied upon him
- Defendant operated with discretion in assisting the Plaintiff

What are the **types** of duties that fiduciaries owe?

- ◆ Good faith and candor
- ◆ Refrain from self-dealing
- ◆ Care and Loyalty
- ◆ Full disclosure
- ◆ Act with the strictest integrity
- ◆ Fair, honest dealing

Presumption of Unfairness

When a fiduciary profits from a transaction with its beneficiary, an equitable presumption exists that the transaction was unfair to the party that did not profit/benefit, placing the burdens of persuasion *and* evidence on the fiduciary to prove the transaction's fairness.

Defendant must then show:

- That the transaction was made in good faith;
- That the transaction was fair and equitable to the Plaintiff; and
- That the transaction was made after full disclosure of all material information to the Plaintiff.

Fiduciary Litigation: Limitations

- ❖ Be aware that the CPRC, §16.004(a)(5) limits breach of fiduciary duties actions at four years
- ❖ The discovery rule may serve to extend this, given the trust and confidence nature of the fiduciary relationship
- ❖ The measure is objective: when the plaintiff knew *or should have known* of the fiduciary breach. *In re Estate of Fawcett*, 55 S.W.3d 214 (Tex. App. — Eastland 2001, pet. denied).

Fiduciary Litigation: Scenarios

Securities Brokers, Financial Advisors

- **Non-discretionary brokers = very narrow fiduciary duties.** *Magnum Corp. v. Lehman Bros. Kuhn Loeb, Inc.*, 794 F.2d 198 (5th Cir. 1986).
- **Discretionary brokers = much broader fiduciary duties.** Where the broker has more control over the account, then the broker owes a broader fiduciary duty.

Attorneys

An attorney is charged with acting in the client's best interests at all times with **integrity** and **fidelity**.

The duties owed include:

- Keep the client's communications in strict confidence
- Candor, openness, and honesty, without deception or concealment
- Undivided loyalty
- Duty to follow the client's confidences
- Disclosure regarding settlement discussions

Insurance Relationships

- ❑ Insurance company owes no general fiduciary duty to the insured
- ❑ Insurance agents owe the insurance company a fiduciary duty via agency
- ❑ Insurance agents do not owe their clients a fiduciary duty as a matter of law
- ❑ Insurance agents can owe their clients informal fiduciary duties, where the agent goes beyond the normal scope of that relationship, *Lee v. Hasson*, 286 S.W.3d 1 (Tex. App.—Houston [14th Dist.] Jan. 30, 2007, pet. denied)

Business Relationships

- ❖ Before fiduciary obligations can be imposed in a business transaction, the fiduciary relationship must have existed **before and apart from** the business agreement/transaction made the basis of the lawsuit. *Willis v. Donnelly*, 199 S.W.3d 262, 277 (Tex. 2006).
- ❖ The plaintiff must show evidence of a special relationship of trust and confidence existing **apart from** the business transaction made the basis of the lawsuit, *R.R. Street & Co. v. Pilgrim Enterprises, Inc.*, 81 S.W.3d 276 (Tex. App. – Houston [1st Dist.] 2001, rev'd on other grounds)

Shareholders and Corporations

- Shareholders do not generally owe one another fiduciary obligations, *Pabich v. Kellar*, 71 S.W.3d 500 (Tex. App.—Fort Worth 2002, pet. denied).
- However, a plaintiff minority shareholder may prove that a majority shareholder owed fiduciary duties where his conduct towards minority shareholders was oppressive. *Willis v. Donnelly*, 118 S.W.3d 10 (Tex. App.—Houston [14th Dist.] 2003), *aff'd in part and rev'd in part*, 199 S.W.3d 262 (Tex. 2006) (citing *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied)).
- Corporate directors and officers owe fiduciary duties to the corporation.

Partnerships

- Historically, Texas caselaw held partners to the highest fiduciary standards, see, e.g., *Johnson v. Peckham*, 120 S.W.2d 786 (1936).
- The Texas Revised Partnership Act and Business Organization Code attempted to disavow fiduciary notions from partnership law, yet courts persist in applying fiduciary standards.
- See, e.g., *McBeth v. Carpenter*, 565 F.3d 171, 177 (5th Cir. 2009) (equating a general partner's responsibilities to those of a trustee – i.e., as a fiduciary).

General Partnerships

- Partners within a general partnership owe one another a statutory **duty of care** and a **duty of loyalty**.
- **Duty of Care:** Duty to act in the conduct of the partnership business with that of a prudent person under similar circumstances. Tex. Bus. Org. Code § 152.206.
- **Duty of Loyalty:**
 - ◆ Account and hold for all property, profit and benefit derived in the course of the partner's work for the partnership;
 - ◆ refraining from dealing with the partnership on behalf of a person who has an interest adverse to the partnership;
 - ◆ refraining from competing or dealing with the partnership in a manner adverse to the partnership; Tex. Bus. Org. Code § 152.205.

General Partnerships

- **Quasi-Fiduciary?** The Business Organizations Code (and, before it, the Texas Revised Partnership Act) does not require that the partner always put the partnership's (and other partners') interests ahead of his own, suggesting that partners are **quasi-fiduciaries**.
- **Self-Limiting the Duties.** The Business Organizations Code allows a general partnership to define and limit the duties owed, subject to a "not manifestly unreasonable" standard, § 152.002, so long as the duties of loyalty and care are maintained.

Limited Partnerships

Tex. Bus. Org. Code section 153 controls limited partnerships, which are not bound by section 152's required duties of loyalty and care.

- General partners continue to be held to fiduciary standards. *McBeth v. Carpenter*, 565 F.3d at 177 (5th Cir. 2009).
- Under the Bus. Org. Code, § 153.003(b), a limited partner is not subject to the same fiduciary responsibilities as a general partner solely because of its status as a limited partner.
- Nevertheless, courts have continued to regard limited partners as fiduciaries of one another, *Zinda v. McCann Street, Ltd.*, 178 S.W.3d 883, 891 (Tex.App.—Texarkana 2005, pet. denied), and of the limited partnership itself, *M.R. Champion, Inc. v. Mizell*, 904 S.W.2d 617, 618 (Tex. 1995)
- However, one recent decision, *Red Sea Gaming Inc. v. Block Investments Co.*, --- S.W.3d ---, 2010 WL 108155 at *3-4 (Tex.App.—El Paso 2010), suggests that the courts are recognizing the legislature's move away from traditional views on partners owing fiduciary duties.

Aiding and Abetting a Fiduciary Breach

- A third-party can be liable as a joint tortfeasor where the party *knowingly* participates with another in breaching a fiduciary obligation
- This rule can also be used **defensively** to preclude the third-party aider/abettor from enforcing a contractual right where that right was obtained as a result of the breach of the fiduciary duty, *Remenchik v. Whittington*, 757 S.W.2d 836 (Tex. App.—Houston [14th Dist.] 1988, no writ)

Recoverable Damages

- Actual Damages
 - ◆ economic: can include lost profits
 - ◆ mental anguish: *where foreseeable*
- Exemplary damages: if breach was intentional
- Constructive Trust
- Fee Forfeiture: if plead specifically, court may order all or part of the fiduciary's fees be returned
- Accounting