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Attention Fiduciaries: Do You Know Your Duties?

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No matter who you are or what you do, the odds are you have been a part of a fiduciary relationship—maybe even without knowing it. For instance, have you ever sold a house with assistance from a broker? Have you ever been a director or officer of a corporation, a partner of a partnership, or a shareholder of a closely-held corporation? Have you ever employed others or purchased insurance? The relationships formed by taking the foregoing actions are just a few of those recognized as "fiduciary relationships" under Minnesota law.

It is important to be familiar with the recognized fiduciary relationships because not only are they extremely prevalent in the business world, they are the source of significant legal obligations and enforceable rights. All fiduciary relationships impose legal duties on the fiduciary to do and not do certain things and to always act in the best interests and for the benefit of the beneficiary. A breach of those duties could result in serious consequences for the unsuspecting fiduciary.

When Do Fiduciary Relationships Arise?

The key components of the typical fiduciary relationship include trust, confidence, superior knowledge, and influence. Although each component need not be present to create a fiduciary relationship, these components generally work together so that when one person places trust and confidence in another with superior knowledge, influence over that person can often result.

Fiduciary relationships also arise in business transactions where a disparity in business knowledge or experience exists between the parties. When such a disparity exists, it often results in one party confiding in and relying on another with adverse interests. In this situation, whether or not a fiduciary relationship arises depends, in part, on whether the party with superior knowledge or experience knows of the other party's inferior understanding of the matter at hand.

Importantly, not all relationships involving trust, confidence, superior knowledge, and influence result in fiduciary duties. A prime example of this is the physician-patient relationship. It is axiomatic that patients place trust and confidence in their physicians. It is also clear that physicians exercise superior medical knowledge over their patients such that the patient's medical decisions are easily influenced by the physician. Despite all the indications of a fiduciary relationship, Minnesota courts have declined to categorize the physician-patient relationship as fiduciary in nature.

Thus, when examining your own relationships to determine your respective duties and rights, it is important to be aware of those relationships that have been expressly acknowledged as fiduciary in nature by the legislature and courts.

What Are the Duties of A Fiduciary?

A fiduciary's duties depend on the type of fiduciary relationship that exists.

A. Corporate Directors and Officers

Corporate directors and officers owe two fiduciary duties to the corporation and its stockholders: a duty of care and a duty of loyalty. The duty of care requires directors and officers to discharge the duties of their positions with the care an ordinarily prudent person in a like position would exercise under similar circumstances. They should also act in the best interests of the corporation at all times. Despite these seemingly broad duties, Minnesota courts rarely impose liability on corporate directors or officers *solely* for duty of care violations and usually will not do so absent fraud, collusion, or similar misconduct.

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The duty of loyalty requires directors and officers to discharge their corporate duties in good faith and in a manner reasonably believed to be in the best interests of the corporation. Generally, the duty of loyalty prohibits directors and officers from assuming positions in conflict with the corporation's interests and from engaging in self-dealing by usurping corporate opportunities. Directors with personal interests in corporate transactions still may engage in such a transaction as long as doing so is fair and reasonable to the corporation, the transaction is disclosed to the shareholders, and the transaction is approved by the shareholders or ratified by the directors.

B. Managers and Governors of Limited Liability Companies

The fiduciary duties owed by managers and governors of limited liability companies ("LLCs") are identical to those of directors and officers of corporations.

C. Partners

Partners in a partnership owe duties of loyalty and care to the partnership and to the other partners, with one exception: In limited partnerships, only general partners owe fiduciary duties. Both duties must be discharged consistently with the obligation of good faith and fair dealing. In the partnership setting, the duty of loyalty includes:

- Accounting to the partnership and holding as trustee for it any property, profit, or benefit received by the partner;
- Refraining from dealing with the partnership as or on behalf of a party having an interest adverse to the partnership; and
- Refraining from competing with the partnership.

Courts have limited the duty of care in the partnership setting to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

Although not specifically considered a fiduciary duty, partners must also disclose material facts to each other. In limited partnerships, this disclosure requirement includes, upon demand of another partner, providing full information regarding the partnership's state of activities and financial condition. In other partnerships, the disclosure duty includes providing access to the partnership's books, records, and information concerning its business and affairs.

D. Shareholders in Closely-Held Corporations

In a closely-held corporation (defined in Minnesota as corporations with *35 or fewer* shareholders), shareholders owe duties to other shareholders that can be considered fiduciary in nature.

Shareholders are held to the highest standard of integrity and good faith in their dealings with each other. They must deal openly, honestly, and fairly and must disclose material information to each other about the corporation. Finally, those in control of closely-held corporations must refrain from acting in a manner that is unfairly prejudicial or in a manner that frustrates the reasonable expectation of the minority shareholders. If they do, the prejudiced shareholder may be entitled to equitable relief, and the corporation may even face involuntary dissolution.

E. Agents

Agency is the fiduciary relationship that results from manifestation of consent by one person to another that the other shall act on his or her behalf and subject to his or her control, and the consent by the other party to so act. Agency principles are often used by courts when considering whether to impose fiduciary duties upon a party to a transaction. If a party is deemed to be an agent, that party has a duty to act for the benefit of the principal in all matters related to the agency relationship. Agents also owe the duty of full disclosure and must exercise utmost fidelity toward the principal.

F. Employees

Employees have a fiduciary duty to act in the interest of the employer and not as an adversary. Employees must not solicit business of the employer before leaving the employment relationship, must not disclose or misappropriate the employer's trade secret information, and must refrain from engaging in serious misconduct akin to embezzlement or referring customers to competitors. The fiduciary duties of an employee are heightened if the employee is also an officer, director, shareholder, or partner in the employing entity.

G. Insurers

An insurer owes its insured a fiduciary duty to represent the insured's best interests, and to defend and indemnify the insured. The insurer's duty is measured by the "good faith" standard. To exercise good faith, the insurer must view a situation as if there were no policy limits applicable to the claim and give equal consideration to the financial exposure of the insured.

H. Trustees

An individual having legal title to property held in trust for the benefit of another owes fiduciary duties to that beneficiary. If there are multiple beneficiaries, the trustee must deal impartially with the beneficiaries and manage the trust with equal consideration for the interests of all beneficiaries.

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A trustee's other duties include:

- Preserving trust property;
- Keeping trust property separate from the trustee's own property;
- Disclosing to the beneficiaries all facts pertaining to the trust;
- Keeping complete and accurate records;
- Administering the trust solely for the benefit of the beneficiaries; and
- Dealing fairly with all beneficiaries.

Further, a trustee having trust powers under wills, agreements, court orders, or other instruments owes a duty to invest and manage the trust's assets prudently. This duty includes considering the purposes, terms, distribution requirements, and other circumstances of the trust and considering the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust. In satisfying the "prudent" investment standard, the trustee must exercise reasonable care, skill, and caution. Finally, trustees must refrain from investing or managing trust assets in a manner that defeats the settlor's intent or the trust's purposes.

I. Real Estate Brokers

Residential real estate brokers' duties to their principals arise out of agency principles. Brokers owe their principals the duties of good faith and loyalty. Part of the duty of loyalty requires brokers to divulge all material facts of which the broker has knowledge that could adversely and significantly affect an ordinary purchaser's use or enjoyment of the property or any intended use of the property. The duty to disclose also requires brokers to make full disclosure of a prospective buyer's financial status. Further, from the outset of the relationship, brokers are required by statute in Minnesota and many other states to set forth the type of agency relationship that will exist in an agency disclosure form (*i.e.*, seller's broker, buyer's broker, subagent, dual agency broker, or facilitator).

Conclusion

Whenever embarking on a new relationship, purchasing shares in a closely-held corporation, accepting employment, or becoming a trustee, be sure you know exactly what is expected of you and the other parties to the transaction or venture. This article merely brushes the surface of an area of law that affects us all in a variety of ways. Obtaining the advice of counsel is the most efficient and reliable method of becoming informed and avoiding potentially devastating consequences that may result from even the smallest deviation from your legal duties.