


UNDERSTANDING THE SCOPE OF FIDUCIARY DUTIES: Duty of Care & Duty of Loyalty




CAPCO Board of Directors Training
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Definition Basics


- A **fiduciary relationship** exists where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and in due regard to the one or entity reposing confidence.
- It is not necessary that there be a technical or legal relationship for a fiduciary relationship to exist.
- The fiduciary relationship extends to any possible case in which a fiduciary relationship exists in fact, and in which there is confidence reposed on one side, and resulting domination and influence on the other.



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Guiding Principle

- Fiduciaries must act in good faith and can never paramount their personal interest over the interest of those for whom they have assumed to act.
- Some of a trustee's duties include:
 - duty of loyalty
 - impartiality
 - prudent administration
 - control and protection of trust property
 - record keeping
 - duty to inform and report.



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Directors and Officers: D & O

- Directors and officers owe fiduciary duties to their corporations that arise **by law, as a matter of law.**
- Directors of non-profit corporations and entities are required to act in good faith, with due care, and in a manner they reasonably believe to be in the best interests of the corporation.
- Directors and officers owe a fiduciary duty to the corporation and the shareholders.



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Directors and Officers: D & O

- Directors are to fulfill their duties: (a) in good faith, (b) with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (c) in a manner the director reasonably believes to be in the best interests of the corporation.
- A director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared by: (a) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented; (b) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within their professional or expert competence; or (c) a committee or subcommittee of the board of directors of which the director is not a member if the director reasonably believes the committee or subcommittee merits confidence.
- The duties of officers are the same as the duties of directors.



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D & O Liability

- If officers or directors breach these fiduciary duties are subject to criminal and civil liability.
- Directors and officers generally cannot directly be sued but may be held liable their share of harm to the organization and its stakeholders.
 - However, individual actions may be prosecuted if the plaintiff can show either (1) that the wrongdoer owed him a special duty, or (2) that the injury suffered by the guarantor is personal to him and distinct from the injury sustained by the corporation itself.
- Directors are entitled to a good faith defense against liability if they comply with the requirements of the statute.
- In addition, a corporation's Articles of Incorporation may limit a director's liability.



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Business Judgment Rule

- The business judgment rule insulates directors and officers from legal liability for mistakes, presumed to be made in good faith, unless there is sufficiently specific evidence to support otherwise.
- The rule prevents a court from unreasonably reviewing or interfering with managerial decisions by the business's directors, thereby insulating directors from the hindsight of judicial second guessing of those management decisions.
- The rule creates the presumption that in making a decision on behalf of the business, the directors acted with due care and in good faith in the honest belief that the action was in the best interest of the business.
- Absent rebuttal of the initial due care presumption, a decision by loyal and informed directors will not be overturned by a court unless it cannot be attributed to any rational business purpose.



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Fiduciary Duties of Professionals: Attorneys, Accountants, etc: Attorneys

- Additional consequences apply to lawyers who breach their fiduciary duties.
- "When an attorney breaches the duty owed to his client, there is a presumption of fraud." Booher v. Frue, 98 N.C. App. 570, 584 (N.C. App. 1990)(citing N.C. Gen. Stat. § 84-13)("If any attorney commits any fraudulent practice, he shall be liable in an action to the party injured, and on the verdict passing against him, judgment shall be given for the plaintiff to recover double damages."))



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Fiduciary Duties of Professionals: Attorneys, Accountants, etc: Attorneys

- In addition to typical fiduciary duties, every state's Rules of Professional Conduct impose and reinforce duties similar to fiduciary duties. Such Rules obligate the lawyer to duties not just their clients, but others.
- For instance:
 - An attorney should "zealously assert the client's position" and "seek a result advantageous to the client," but the lawyer must do so "consistent with requirements of honest dealing with others."
 - A lawyer cannot "counsel a client to engage...in conduct that the lawyer knows is criminal or fraudulent..."
 - A lawyer must keep client information confidential.
 - The rules also strictly limit a lawyer's ability to enter into transactions with clients, represent new clients with interests adverse to former clients, use information gained from a client against the client, and receive gifts from clients.



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Fiduciary Duties of Professionals: Accountants

- Accountants do not owe a per se (or de jure) fiduciary duty.
- That does not mean that a fiduciary duty cannot arise in fact, based on the circumstances (*de facto*).
- As with lawyers, CPAs are subject to their own rules governing Professional Ethics and Conduct.
 - These rules impose duties of confidentiality with respect to client information, and prohibit conflicts of interest in various areas, including transactions with clients.



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Other Fiduciary Relationships

- One other, but important, observation: The relationship between an employer and employee is not a fiduciary one.



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Duty of Loyalty

- Duty of loyalty as the responsibility to avoid harming the principal and the duty of care, as a responsibility to act diligently.
- Duties involving loyalty can be simplified and rendered less subject to conflicts with “prophylactic rules” – black and white rules that eliminate conflicts but may cut too broadly and have unintended consequences.
 - For instance, in many instances’ fiduciaries are blanketly forbidden from engaging in transactions with principals even for a fair price.



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Duty of Care

- With directors and professionals, the duty of care can be quite subjective.
- Reviewing materials and monitoring delegated activities can help satisfy the duty.
- Directors need not have detailed knowledge about all aspects of an organization – and lawyers need not press every advantage.
- Every director will handle things differently – the standard is to focus on process, using prudence, reasonableness, and acting in good faith.



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Sources

- New York State Community Action Association(NYSCAA)
- CAPLAW-Community Action Program Legal Services, Inc.
- Terpening Law Group, PLLC



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