**Fiduciary Duties: Understanding the Scope and Liabilities**

**July 28, 2020**

**William R. Terpening[[1]](#footnote-1)**

**Terpening Law, Charlotte, NC**

[**terpening@terpeninglaw.com**](mailto:terpening@terpeninglaw.com)

**(980) 265-1700**

**A. Fiduciary Relationships, Duties, and Regulations.**

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 reposing confidence. *Moore v. Bryson*, 11 N.C. App. 260, 265 (1971). “[I]t is not necessary that there be a technical or legal relationship for a fiduciary relationship to exist.” *Id.* at 265. 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.” *Dalton v. Camp*, 353 N.C. 647, 652 (2001) (quoting *Abbitt v. Gregory*, 201 N.C. 577, 598, 160 S.E. 896, 906 (1931) (quoting 25 C.J. Fiduciary § 9, at 1119 (1921))).

A fiduciary duty can be established under two approaches: by operation of law (*de jure*) and based on the facts and circumstances (*de facto*). *Lockerman v. South River Elec. Mbrshp. Corp.*, 250 N.C. App. 631, 635-36 (2016), citing *Abbit*, 201 N.C. at 598. *De jure* fiduciary relationships include specifically recognized relationships, such as attorney-client, and principal-agent. *Lockerman*, 250 N.C. App. at 636. As one seminal case notes, “North Carolina recognizes certain de jure fiduciary relationships which arise as a matter of law because of the nature of the relationship, such as attorney and client, broker and principal, executor or administrator and heir, legatee or devisee, factor and principal, guardian and ward, partners, principal and agent, trustee and cestui que trust.” *Abbitt*, 201 N.C. at 598.

*De facto* fiduciary relationships arise from “facts and circumstances establishing a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.” *Hajmm Co. v. House of Raeford Farms, Inc.*, 328 N.C. 578, 588 (1988). Courts have “historically declined to adopt a rigid definition of a fiduciary relationship in order to allow imposition of fiduciary duties,” so “the relationship can arise in a variety of circumstances… and may stem from varied and unpredictable factors.” *Hajmm*, 328 N.C. at 588. Back in 1931, the NC Supreme Court “declined to define the term fiduciary and thereby exclude from this broad term any relation that may exist between two or more persons with respect to the rights of persons or property of either,” noting that “it need not be legal; it may be moral, social, domestic or merely personal.” *Abbitt*, 201 N.C. 577, 598.

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. *See Moore*, 11 N.C. App. at 265.

1. **Trustees and Executors.**

Trustees and executors act in a fiduciary capacity. *See* N.C. Gen. Stat. § 32-2(a)(“‘Fiduciary’ includes a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer, or any other person acting in a fiduciary capacity for any person, trust or estate.”); *see also* *Allen v. Currie, Commissioner of Revenue*, 254 N.C. 636 (1961); *In re Will of Covington*, 252 N.C. 551 (1960); *McMichael v. Proctor*, 243 N.C. 479 (1956).

Particular risks exist for attorneys who serve as executors. For example, the lawyer cannot take extra compensation although he applies his legal skills to the probate process. “When a lawyer voluntarily becomes executor[,] he takes the office *cum onere*, and although he exercises his professional skill in conducting the estate he does not thereby entitle himself to compensation beyond the amount ordinarily allowed to an executor or an administrator.” *Lightner v. Boone*, 221 N.C. 78, 86 (N.C. 1942). “In the absence of statute, the general rule is that where a lawyer becomes executor or administrator, his compensation as such is in full for his services, although he exercises his professional skill therein; and even if he performs duties which he might properly have hired an attorney to perform, he is not entitled to attorneys’ fees.” 21 Am. Jur., 679. The rationale for this rule is that the lawyer/executor should not risk breaching his fiduciary duties by allowing his interests to conflict with his duties as a fiduciary. “It has been said that if an executor chooses to exercise his professional skill as a lawyer in the business of the estate, it must be considered a gratuity, and that to allow him to become his own client and charge for professional services would be holding out inducements for professional men to seek such representative places to increase their professional business which would lead to most pernicious results.” *Lightner*, 221 N.C. at 86, 19 S.E.2d at 150.

In North Carolina, a trustee’s duties are codified in the N.C. General Statutes Section 36C, also known as the Uniform Trust Code. Similar to North Carolina’s LLC Act, however, many of the duties can be expanded or curtailed by the express, written terms of the trust. N.C. Gen. Stat. § 36C-1-105. Specifically, N.C. Gen. Stat. § 36C-1-105 provides that “except otherwise provided in the terms of the trust, this Chapter governs the duties and powers of a trustee and a power holder under Article 8A of this Chapter.” Subsection (b) of the same section states, “the terms of a trust prevail over any provision of this Chapter except,” and continues to list thirteen instances in which a trust instrument cannot override the statutory duties. One of those duties that cannot be overridden by trust instrument includes, “the duty of a trustee or a power holder . . . to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.” N.C. Gen. Stat. § 36C-1-105(b)(2). By default, The NC Uniform Trust Code establishes the duties and powers of the trustee in substantial detail. N.C. Gen. Stat. § 36C-8-801, *et seq*. (b)(2). Among others, 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. *Id*. It is important for a trustee to keep in mind, that even if a trust instrument does not specifically address the duties and powers of the trustee, the North Carolina Uniform Trust Code is applicable by default and imposes duties that could be used as the basis for a breach of fiduciary duty or constructive fraud claim.

1. **Members/Managers of LLCs, Partners, Directors, and Officers.**

***Members and Managers of LLCs***

Because LLC’s are principally a creature of contract, the operating agreement can “impose or eliminate fiduciary duties for members and managers.” *Vanguard Pai Lung, LLC v. Moody*, 2019 NCBC LEXIS 39, \*18, 2019 NCBC 38, 2019 WL 2526461 (N.C. Super. 2019). In this regard, “[t]he fiduciary duties owed by corporate directors…are not identical to the fiduciary duties owed by an LLC manager.” *Plasman v. Decca Furniture (USA), Inc.*, 2016 NCBC 78, 54, 2016 NCBC LEXIS 80, \*35, 2016 WL 6208639 (N.C. Super. Oct. 21, 2016). The difference is that an LLC Manager’s duties can be contractually changed in the operating agreement. Indeed, the LLC Act and common law will “apply only to the extent contrary or inconsistent provisions are not made in, or are not otherwise supplanted, varied, disclaimed, or nullified by, the operating agreement.” N.C.G.S. § 57D-2-30.

Aside from what the parties decide to agree to in the operating agreement, or if the operating agreement is silent, North Carolina’s default LLC Act imposes fiduciary responsibilities on Managers of LLCs. According to N.C.G.S. § 57D-3-21(a), “managers shall manage the LLC and conduct the LLC's business in accordance with the operating agreement.” Further “[e]ach manager shall discharge that person's duties (i) in good faith, (ii) with the care an ordinary prudent person in a like position would exercise under similar circumstances, and (iii) subject to the operating agreement, in a manner the manager believes to be in the best interests of the LLC.” N.C.G.S. § 57D-3-21(b). In fulfilling these duties, “a manager is entitled to rely on information, opinions, reports, or statements, including financial statements or other financial data, if prepared or presented by any person or group of persons the manager believes to be reliable and competent in such matters and the manager does not have actual knowledge concerning the matter in question that makes such reliance unwarranted.” N.C.G.S. § 57D-3-21(b). The statute provides for a good faith defense to liability: “A manager is not liable to the LLC for any act or omission as a manager if the manager acts in compliance with this section.” N.C.G.S. § 57D-3-21(c). The Manager owes these fiduciary duties to the LLC, not the other Members. *Chisum v. Campagna*, 2017 NCBC LEXIS 102, \*13, 2017 NCBC 100, 2017 WL 5161978 (Nov. 7, 2017). “Under North Carolina law, members of an LLC are treated like corporate shareholders and managers are similar to directors.” *Id.* at \*14. But again, note that this similarity between shareholders and managers is subject to the caveat that this refers only to the default statutory LLC Act, which can be contractually overridden by the operating agreement.

The LLC Act imposes additional liability on Managers for improper distributions. As background, § 57D-4-05 states in part “[n]o distribution may be made by an LLC if, after giving effect to the distribution, either of the following would occur: (1) The LLC would not be able to pay its debts as they become due in the ordinary course of business[, or] (2) The LLC's total liabilities would exceed the value of the LLC's assets.” If that occurs, the Manager who approved the improper distribution is personally liable “for the amount of the distribution that exceeds the amount that could have been distributed without violating G.S. 57D-4-05….” However, that liability is mitigated by N.C.G.S. § 57D-3-21, which was discussed above – the Manager is only liable if he did not act in compliance with that provision. In other words, the same good faith protections that apply to Managers’ actions in general apply to the distribution restrictions.

As for the Members, “[a]s a general rule, members of an LLC do not owe a fiduciary duty to one another, but in some circumstances, ‘a holder of a majority interest who exercises control over the LLC owes a fiduciary duty to minority interest members.’” *Vanguard Pai Lung, LLC v. Moody*, 2019 NCBC LEXIS 39, \*17, 2019 NCBC 38, 2019 WL 2526461 (N.C. Super. Ct. Jun. 19, 2019)(quoting *Fiske v. Kieffer*, 2016 NCBC LEXIS 22, at \*9 (N.C. Super. Ct. Mar. 9, 2016), and citing *Kaplan v. O.K. Techs.*, L.L.C., 196 N.C. App. 469, 473 (2009)). Still, the LLC Act does not give rise to fiduciary duties between members or by members to the LLC – “Members of a limited liability company are like shareholders in a corporation in that members do not owe a fiduciary duty to each other or to the company.” *Kaplan v. O.K. Techs., L.L.C.*, 196 N.C. App. 469, 473 (N.C. App. 2009).

***Partners***

Partners are in a fiduciary relationship with each other as a matter of law:

It is elementary that the relationship of partners is fiduciary and imposes on them the obligation of the utmost good faith in their dealings with one another in respect to partnership affairs. Each is the confidential agent of the other, and each has a right to know all that the others know, and each is required to make full disclosure of all material facts within his knowledge in any way relating to the partnership affairs.

*Compton v. Kirby*, 157 N.C. App. 1, 15 (N.C. App. 2003). *See also Hajmm Co.,* 328 N.C. at 588 (“Business partners . . . are each other's fiduciaries as a matter of law.). “These duties include providing full information to the partnership, accounting for the use of partnership property, disclosing self-dealing transactions, and remitting profits obtained through transactions affiliated with the partnership's business.” *Chesson v. Rives*, 2013 NCBC 49, 26, 2013 NCBC LEXIS 46, \*13 (N.C. Super. 2013).

As with other fiduciary relationships addressed in this presentation, this has been codified in North Carolina. *See* North Carolina’s Uniform Partnership Act (N.C. Gen. Stat. §§ 59-31 to 73). The Partnership Act expressly creates a fiduciary duty: “Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct or liquidation of the partnership or from any use by him of its property.” N.C. Gen. Stat. § 59-51. Fiduciary duties in North Carolina’s Partnership Act include a duty to provide each other with information: “Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or partner under legal disability.” N.C. Gen. Stat. § 59-50. Moreover, “partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them.” N.C. Gen. Stat. § 59-49. Partners have broad rights to an accounting of the partnership. N.C. Gen. Stat. § 59-52.

Unlike an LLC’s operating agreement, “[a] partnership agreement cannot eliminate those enumerated fiduciary duties partners owe to one another as a matter of law.” *Chesson v. Rives*, 2013 NCBC 49, 26, 2013 NCBC LEXIS 46, \*13, 2013 WL 5864582 (N.C. Super. Oct. 28, 2013)(citing N.C. Gen. Stat. § 59-60; *Hajmm Co.*, 328 N.C. at 588; *Casey v. Grantham*, 239 N.C. 121 (1954); *Tai Sports, Inc. v. Hall*, 2012 NCBC LEXIS 64, at \*96 (N.C. Super. Ct. Dec. 28, 2012)). This represents a significant distinction between LLC’s and rights and responsibilities of the managers and members of LLCs, which can all be contractually changed in the LLC’s operating agreement.

***Officers and Directors***

Officers and directors owe fiduciary duties to their corporations that arise *de jure*, as a matter of law. “In North Carolina, directors of a corporation 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.” *Green v. Freeman*, 367 N.C. 136, 141 (N.C. 2013) (citing N.C.G.S. § 55-8-30 (2011)). Similarly, “officers of a corporation owe a fiduciary duty to the corporation and the shareholders.” *T-Wol Acquisition Co. v. ECDG South, LLC*, 220 N.C. App. 189, 208 (2012) (citing *Meiselman v. Meiselman*, 58 N.C. App. 758, 774 (1982)).

If officers or directors breach these fiduciary duties to the corporation, its shareholders can sue them in a derivative action on the corporation’s behalf, in which case any damages recovered will flow back to the corporation. *See id.* Shareholders generally cannot directly sue officers and directors for their share of harm to the corporation. *See id.* at 142, 268. However, “individual actions may be prosecuted, however, if the guarantor 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.” *Barger v. McCoy Hillard & Parks*, 346 N.C. 650, 661 (N.C. 1997).

Under North Carolina statute, directors are to fulfill their duties to the corporation: (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. N.C. Gen. Stat. § 55-8-30(a). A director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by any of the following: (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. N.C. Gen. Stat. § 55-8-30(b). Directors are entitled to a good faith defense against liability if they comply with the requirements of the statute: “A director is not liable for any action taken as a director, or any failure to take any action, if the director performed the duties of the director's office in compliance with this section….” N.C. Gen. Stat. § 55-8-30(d). In addition, a corporation’s Articles of Incorporation may limit a director’s liability. N.C. Gen. Stat. § 55-2-02 (Articles may include “[a] provision limiting or eliminating the personal liability of any director arising out of an action whether by or in the right of the corporation or otherwise for monetary damages for breach of any duty as a director.”). As you’ll note, the statutory language is similar to the LLC Act.

The duties of officers are the same as the duties of directors. Case law instructs that corporate officers “act in a fiduciary capacity in the sense that they owe the corporation the duties of loyalty and due care.” *Seraph Garrison, LLC v. Garrison*, 2016 N.C. App. LEXIS 1376, \*6-7 (N.C. App. 2016) (citing *Belk v. Belk's Dep't Store, Inc.*, 250 N.C. 99, 103 (1959); *Loy v. Lorm Corp.*, 52 N.C. App. 428, 436 (1981); *Pierce Concrete, Inc. v. Cannon Realty & Constr. Co.*, 77 N.C. App. 411, 413-14 (1985)(the fiduciary duty corporate officers owe to North Carolina corporations “is a high one”)). A “requirement of good faith is subsumed under an officer's duties to the corporation; it is a primary and comprehensive obligation that compels an officer to discharge his responsibilities openly, honestly, conscientiously, and with the utmost devotion to the corporation.” *Seraph*, 2016 N.C. App. LEXIS 1376, at \*9.

Certain types of transactions by officers presumptively are considered a violation of fiduciary duties. Self-interested transactions, for example, such as use of corporate credit cards for personal transactions, are presumed to violate the fiduciary duties of a corporate president under North Carolina law. *See Lecann v. Cobham*, 2012 NCBC 56 at \*56 (10 CVS 1169) (Super. Ct. Nov. 7, 2012) (citing *Green River Mfg. Co. v. Bell*, 193 N.C. 367, 371 (1927)). Conversion of corporate money constitutes breach of an officer’s *de jure* fiduciary duty. *State v. Martin*, 85 N.C. App. 410, 418 (1987).

***Business Judgment Rule***

As discussed in the section above, under the North Carolina Business Corporations Act:

A director shall discharge his duties as a director, including his duties as a member of a committee: (1) In good faith; (2) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) In a manner he reasonably believes to be in the best interests of the corporation.

*State v. Custard*, 2010 NCBC 6, 59, 2010 NCBC LEXIS 9, \*54. These statutorily-created fiduciary duties, however, do not necessarily subject a director to legal liability for management decisions that turn out not to be in the corporation’s best interest. Rather, this standard is subject to review within the limits of the 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. *Alford v. Shaw*, 318 N.C. 289, 299, 349 S.E.2d 41, 47 (1986) (Holding that “[i]n North Carolina, as elsewhere, “the business judgment rule has provided the yardstick against which the duties and decisions of corporate officers and directors.”).

The business judgment rule and its substance are matters of judicial creation, not by legislation or statute. *State v. Custard*, 2010 NCBC 6, 60, 2010 NCBC LEXIS 9, \*56 (quoting Russell M. Robinson, II, *Robinson on North Carolina Corporation Law* § 14.03[1] (7th ed. 2009). As a concept, the business judgment rule is the extension of the fundamental principal that the management of a business and its affairs are entrusted to officers and directors as duly authorized representatives of the shareholders. *1 Robinson on North Carolina Corporation Law* § 14.06 (2019). 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. *Id*.

In doing so, the rule essentially operates as a rule of evidence and 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. *Id*.; *see also* *Hammonds v. Lumbee River Elec. Mbrshp. Corp.*, 178 N.C. App. 1, 20-21, 631 S.E.2d 1, 13 (2006). Second, 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. *Id*. “Absent proof of bad faith, conflict of interest, or disloyalty, the business decisions of officers and directors will not be second-guessed if they are the product of a rational process, and the officers and directors availed themselves of all material and reasonably available information and honestly believed they were acting in the best interest of the corporation.” *Custard*, 2010 NCBC LEXIS at \*58 (citing *In re Citigroup Inc. S'holder Derivative Litig.,* 964 A.2d 106, 124 (Del. Ch. 2009)).

In essence, bare allegations of breaches of fiduciary duties by directors or a board are not enough to rebut the rule’s presumptions. *Wachovia Capital Partners, LLC v. Frank Harvey Inv. Family L.P*., 2007 NCBC 7, 23, 2007 NCBC LEXIS 7, \*12. Rather, to overcome the presumptions of the business judgment rule, the allegations that a director’s action to which the business judgment rule applies must set forth specific facts to overcome the presumptions that the act was valid. *Maurer v. Maurer*, 2013 NCBC 44, 34, 2013 NCBC LEXIS 41, \*18, 2013 WL 4647703. At a minimum, “to overcome the presumption of the business judgment rule, the burden is on the plaintiff to show the defendant directors failed to act (1) in good faith, (2) in the honest belief that the action taken was in the best interest of the company, or (3) on an informed basis.” *Winters v. First Union Corp*. , 2001 NCBC 8, P17, 2001 NCBC LEXIS 5, \*11; *see also* *Krim v. Pronet,* 744 A.2d 523, 527 (1999).

For instance, in *Winters v. First Union Corp*., the North Carolina Business Court held that simple conclusions of law were insufficient to overcome the presumptions of the business judgment rule. 2001 NCBC 8, P18, 2001 NCBC LEXIS 5, \*11. In that case, the plaintiffs alleged:

The proposal and recommendation of the individual defendants to defendant First Union Corporation that it merge with Wachovia Corporation, was a breach of the fiduciary duty to the individual defendants and to defendant First Union Corporation, in that the proposed merger is not in the best interest of the corporation; and exceeded the permissible scope of the business judgment of the individual defendants, since the merger cannot be attributed to any rational business purpose, the proposal and recommendation was not made with reasonable and due care, and the individual defendants lacked adequate preparation, complete available information, analysis, and competent and independent financial and legal advice that would lead to a responsible decision.

*Id*.

In sum, the business judgment rule does not absolve a director of liability for their decisions altogether. Rather, the business judgment rule requires those seeking to hold a director liable for their decisions to specifically allege that the director did not act in good-faith, or neglected essential functions of their role in making the decision to rebut the presumption of director good faith.

**3. Fiduciary Duties of Professionals: Attorneys, Accountants, *et cetera*.**

***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.”)).

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, North Carolina Rule of Professional Conduct 0.1 instructs not only that a lawyer 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…” N.C. R. Prof. Conduct 1.2(d). A lawyer must keep client information confidential, of course. N.C. R. Prof. Conduct 1.6. The rules also strictly limit a lawyer’s ability to enter into transactions with clients (Rule 1.8), represent new clients with interests adverse to former clients (Rule 1.8 and 1.9), use information gained from a client against the client (Rule 1.8), and receive gifts from clients (Rule 1.8).

On a related note, “an attorney may be liable for aiding and abetting his client's breach of fiduciary duty if he ‘actively participates’ in the conduct constituting the underlying breach of fiduciary duty.” *Zloop, Inc. v. Parker Poe Adams & Bernstein, LLP*, 2018 NCBC LEXIS 16, \*44, 2018 NCBC 16, 2018 WL 943954 (N.C. Super. Feb. 16, 2018). However, “a lawyer or law firm cannot be liable for the representations of a client, even if the lawyer incorporates the client's misrepresentations into legal documents or agreements necessary for closing the transaction,” and is not liable if he merely performs the role of scrivener. *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991)(“ In this case, Weinberg & Green merely "papered the deal," that is, put into writing the terms on which the Schatzes and Rosenberg agreed and prepared the documents necessary for closing the transactions.”). For instance, if a lawyer input inaccurate client misrepresentations into a financial statement, the lawyer would not be liable to others.

***Accountants***

Accountants do not owe a *per se* (or *de jure*) fiduciary duty. *Harrold v. Dowd*, 149 N.C. App. 777, 784 (N.C. App. 2002)(“We have found no case stating that the relationship between accountant and client is per se fiduciary in nature.”). That does not mean that a fiduciary duty cannot arise in fact, based on the circumstances (*de facto* fiduciary duty, discussed above). *Hajmm,* 328 N.C. at 588 (1988)(De facto fiduciary relationships arise from “facts and circumstances establishing a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.”). *See also Chisum v. MacDonald*, 2018 NCBC LEXIS 34, \*25, 2018 NCBC 33 (N.C. Sup. Ct. Apr. 18, 2018)(“In order to plead a fiduciary relationship arising from an accountant-client relationship a plaintiff must allege circumstances sufficient to show that a fiduciary relationship existed between the parties.”).

As with lawyers, CPAs are subject to their own rules governing Professional Ethics and Conduct. See N.C. Admin. Code, Title 21, Subchapter 08N – Prof. 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.

**4. Other Fiduciary Relationships.**

Investment advisors, under North Carolina law, owe no *de jure* fiduciary relationship to their clients. Rather, their situation is analogous to that of accountants. “The mere assertion of an investment advisor-client relationship or reliance upon [N.C. Gen. Stat. 78C *et seq*.] does not give rise to a *de jure* fiduciary relationship.” *Silverdeer, LLC v. Berton*, 2013 NCBC 24, 73, 2013 NCBC LEXIS 21, \*27-28, 2013 WL 1792524 (Apr. 24, 2013). As with accountants and their clients, any fiduciary relationship would have to be established by facts and circumstances: “[W]ithout sufficient alleged circumstances showing the existence of a relationship of confidence and trust (*i.e.*, a *de facto* fiduciary relationship), Plaintiffs' Claim for breach of fiduciary duty against Peters must fail.” *Id.*

As noted, a fiduciary duty can be established between an individual defendant and a company as a matter of fact, not only as a matter of law. *Stone St. Partners, LLC v. Williamson*, 17 CVS 15265. 2018 NCBC 75 at \*56 (N.C. Super. Ct. 2018). “Courts have historically declined to offer a rigid definition of a fiduciary relationship in order to allow imposition of fiduciary duties,” and so “the relationship can arise in a variety of circumstances, and may stem from varied and unpredictable factors.” *Hajmm*, 328 N.C. at 588. Courts will find a *de facto* fiduciary relationship “when one party figuratively holds all the cards—all the financial power or technical information, for example.” *Lockerman*, 250 N.C. App. at 636.

One other, but important, observation: The relationship between an employer and employee is not a fiduciary one. *Dalton*, 353 N.C. at 652.

**B. Case Law Review.**

Below are a few seminal cases concerning breach of fiduciary duty in North Carolina. These cases highlight the elements of a breach of fiduciary claim in various contexts.

***Dalton v. Camp*, 353 N.C. 647 (2001).**

This case concerns an employer’s allegations against its former employees and a new corporation formed by those former employees for unfair competitive activity. Plaintiff Earl Dalton produced, under a thirty-six-month contract, a newspaper for Klaussner Furniture Industries (“KFI”) and employed Defendant David Camp as a production assistant. After the contract with KFI expired, negotiations with KFI to extend the contract were ongoing, and Dalton continued to publish the newspaper without the benefit of a contract. During the lapse period, Camp established a competing publication entity and discussed with KFI the possibility of replacing Dalton as publisher of KFI’s newspaper. Thereafter, Camp resigned from his employment with Dalton approximately two weeks later.

Following Camp’s resignation, Dalton sued Camp for breach of the fiduciary duty of loyalty, among other things. The trial court granted Camp’s motion for summary as to Dalton’s breach of fiduciary duty claim against him and his publication entity. On appeal, the North Carolina Court of Appeals held that granting summary judgement was proper regarding the publication entity and improper as to Camp individually. Upon further review, the North Carolina Supreme Court found there was no breach of fiduciary duty of loyalty against Camp and the judgement of the trial court was reinstated. This case is significant in the fiduciary duty world, because it essentially excepts run-of-the-mill employees from fiduciary duty.

The North Carolina Supreme Court held that for a breach of fiduciary duty to exist, there must first be a fiduciary relationship between the parties. *Dalton*, 353 N.C. at 651. Such a relationship has been broadly defined as “one in which there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interest of the one reposing confidence, and it 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.” *Id*. at 651-52. However, the broad parameters accorded the term “have been” specifically limited in the context of employment situations. Under the general rule, the relation of employer and employee is not of those regarded as confidential. *Id*.

Camp’s managerial duties were such that a certain amount of confidence was reposed in him by Dalton, and as confidant to his employer, Camp was therefore bound to act in good faith and with due regard to Dalton’s interests. *Id*. However, in the Court’s view, without more, this was inadequate to establish fiduciary obligations. *Id*. Rather, the facts display a typical employer-employee relationship. *Id.* The Court held there was no evidence suggesting the essential element, “domination and influence” existed. Camp was not in a position to exercise domination over Dalton. As a result, the Court of Appeals was reversed on this issue. *Id.*

***Southeast Air Charter, Inc. v. Stroud*, 2015 NCBC 79 (N.C. Super. 2015).**

Southeast Air Charter brought a lawsuit against three of its former employees, none of whom were officers or directors of Southeast Air, alleging that they had breached their fiduciary duties. As the North Carolina Supreme Court had already ruled in *Dalton v. Camp*, a breach of fiduciary duty claim against a non-officer or director employee is not viable, the NC Business Court similarly found that absent extraordinary circumstances of special relationship of trust and confidence, leading to dominion and control, employees who are not also officers and directors should not carry the burden of defending fiduciary duty claims.*. Stroud*, 2015 NCBC at 26.

Issuing its Ruling, the Court approved Rule 11 sanctions against Plaintiff for having filed the claims for which there was no reasonable basis to believe were factually supported. The total fees awarded were $14,680. However, after discussion about whether it was reasonable for Plaintiff’s counsel to rely on his client’s representations to make the fiduciary duty claim, the Court ordered that the Plaintiff be responsible the entire burden of the sanction, as opposed to it being shared jointly with counsel.

***Dove v. Harvey*, 168 N.C. App. 687 (2005).**

This case arose from Nicolaus Harvey’s representation of Anthony Dove, in a first-degree murder case in which the State was seeking the death penalty. Dove was convicted of first-degree murder and was sentenced to life in prison. Dove argued that Harvey committed several errors during the trial that helped to secure Dove’s conviction.

Dove argued that the attorney's alleged affair with the assistant district attorney prosecuting his case caused the attorney to intentionally seek the inmate's conviction through lack of zealous representation. Plaintiff sought damages from his criminal trial attorney for acts and omissions that occurred during his trial and brought claims for conspiracy, breach of fiduciary duty, negligence, and gross negligence against defendant. The trial court dismissed plaintiff’s claim for breach of fiduciary duty. On appeal, the trial court’s dismissal was affirmed.

Plaintiff alleged defendant breached a fiduciary duty owed to him by (1) intentionally withholding information regarding his affair with the prosecutor because the affair was a conflict of interest, and (2) willfully lying to plaintiff about an affair with a married woman because defendant was aware plaintiff did not want his representation if he was committing adultery. Even assuming these alleged actions constituted a breach of fiduciary duty by defendant, plaintiff did not allege defendant's actions caused plaintiff damage.

An essential element of a claim for breach of fiduciary duty is actual injury. The Court noted, on the facts of this case, the only possible damage to plaintiff was his conviction for first degree murder. However, plaintiff did not allege defendant's actions were the cause his conviction. Without making this causal connection, the element is not satisfied. Therefore, plaintiff failed to properly allege breach of fiduciary duty and the trial court properly dismissed plaintiff’s claim for breach of fiduciary duty.

***McFadyen v. Duke University*, 786 F. Supp. 2d 887 (M.D.N.C. 2011).**

This case concerns the investigation of members of the Duke University Men’s Lacrosse team on charges of rape, sexual assault, and kidnapping. In this civil suit, Plaintiffs - three members of the lacrosse team - sued Defendants Duke University, Duke University President Richard H. Brodhead, and former District Attorney Michael Nifong. Plaintiffs asserted a claim for breach of fiduciary duty against various Defendants.

As the basis for this claim, Plaintiffs alleged that they were in a fiduciary relationship with Duke and Duke administrators, because the Defendants were in a "position of special confidence and trust" with regard to Plaintiffs’ financial records, educational records, and e-mail accounts. Plaintiffs contended that this relation of trust and confidence imposed a fiduciary duty on Defendants’ to protect these accounts from unauthorized disclosure. Plaintiffs alleged that Duke employees breached their fiduciary duties by accessing and disclosing to Nifong Plaintiffs’ private emails, Duke Card information, and Plaintiffs’ education records.

However, the Court held that a student-administrator relationship is not generally a fiduciary relationship, finding interactions between educators/supervisors do not create a fiduciary relationship because they serve interest outside of the teacher and advisor role. For example, university administrators also serve objectives for the institution and the interest of the public. Due to this “divided loyalty” the fiduciary is not acting primarily for the benefit of another.

In plaintiffs’ brief opposing the defendants’ motion to dismiss, they contended the fiduciary duty was established in several alternative ways, all of which the Court rejected. For example, plaintiffs contended the federal and state banking laws required Duke to safeguard the privacy of plaintiffs’ Duke Card Account transactions. The court rejected this argument for two primary reasons. First, the federal law citied by plaintiffs did not apply. The Family Educational Rights Privacy Act (“FERPA”) only prohibits federal funding of educational institutions that have a policy or practice of releasing educational records to unauthorized persons. However, FERPA does not establish a fiduciary relationship. Second, there is no private right of action under FERPA. The court, therefore, concluded that a FERPA violation does not create a tort claim for breach of fiduciary duty.

***Toomer v. Branch Banking & Trust*, 171 N.C. App. 58 (2005).**

This case concerns a will which created three separate trusts for Williamson Toomer’s children and named United Carolina Bank (“UCB”) as executor. Plaintiffs’ claim against BB&T, as successor-in-interest to UCB, and as trustee under the will for breach of fiduciary duty. The beneficiaries claimed that the bank mismanaged their trusts by improperly valuing assets, overpaying taxes, overcharging for management fees, and making improper withdrawals. The trial court granted the bank’s motion to dismiss, and motion for judgment on the pleadings because the claims were barred by the three-year statute of limitations and the beneficiaries had not stated a claim for constructive fraud. The beneficiaries appealed. On appeal, the trial court’s dismissal and judgment on the pleadings were affirmed.

The issue on appeal was whether plaintiffs’ complaint asserted only claims for breach for fiduciary duty or whether the complaint also stated claims for constructive fraud. Plaintiffs contended that their complaint included claims for constructive fraud, which are governed by a ten-year statute of limitations. The Court held that a claim for constructive fraud based upon a breach of fiduciary duty falls under the ten-year statute of limitations. However, allegations of breach of fiduciary duty that do not rise to the level of constructive fraud are governed by the three-year statute of limitations. So, one point of clarification needed from the courts was, when does a claim for breach of fiduciary constitute constructive fraud?

To answer the question, the court held that to maintain a claim for constructive fraud based on a breach of fiduciary duty, plaintiffs must show that plaintiff and defendants “were in a relation of trust and confidence . . . [which] led up to and surrounded the consummation of the transaction in which defendant is alleged *to have taken advantage of his position of trust to the hurt of plaintiff.*” In this case, the trustee was alleged to have breached its fiduciary duty by charging excess or inflated fees due to errors in valuations and inaccurate appraisals of property values. Noticeably absent from plaintiffs’ claims was the assertion that UCB sought to benefit itself. Accordingly, the Court held plaintiffs had not asserted a claim for constructive fraud, and plaintiffs claim was properly dismissed under the three-year statute of limitations.

The Court found that for cases involving a trustee, the breach of its fiduciary duty begins to run when the claimant “knew or, by due diligence, should have known” of the facts constituting the basis for the claim. If there are facts before the court that call into question when a plaintiff knew or should have known of the facts giving rise to the claim, then this issue must be submitted to the jury. As in this case, if an infant is represented by a guardian, the statute of limitations begins to run when her guardian knew or should have known of the facts giving rise to the claim. For this reason, only one of the breach of fiduciary duty claims asserted by the beneficiaries survived.

***THZ Holdings, LLC v. McCrea*, 753 S.E.2d 344 (N.C. Ct. App. 2013).**

This case concerns the transfer of trust assets by a trustee to himself. The beneficiary sued, alleging the trustee breached his fiduciary duty of loyalty. The duty of loyalty the trustee owes is prescribed by statute and includes entering into a transaction for the trustees’ benefit. The Court found in actions regarding trust instruments, transfers resulting in a breach of the duty of loyalty are voidable by the beneficiaries affected, regardless of whether the transaction was supported by fair consideration.

***Cornelius v. Helms*, 120 N.C. App. 172 (1995).**

This case concerns a real estate contract in which the sellers listed their real property with brokers. During contracting, sellers lost their superior lien position due to an attorney’s actions. The contract provided that the sellers would retain a superior lien until the lender granted a 75 percent loan-to-value construction loan, (meaning their contract would be subordinate only to an amount equal to 75% of the value of the construction improvements on the lot) at which time the seller’s lien would be subordinated. The attorneys prepared the documents to permit the closing of the purchase and construction loan simultaneously. This caused the seller’s lien to be immediately subordinated and the developer received all the loan proceeds. The developer defaulted and the lender purchased the property at foreclosure sale. The sellers brought an action against the attorneys for breach of fiduciary duty.

Plaintiff asserted that an attorney-client relationship existed and that defendants breached their fiduciary duty by not ensuring that plaintiff receive a first lien mortgage on the property. The trial court entered judgement for plaintiffs and defendants appealed. Defendants first contended that the trial court erred by finding the existence of a fiduciary relationship between the parties. The Court of Appeals disagreed.

The relationship of attorney and client may be implied from the conduct of the parties and is not dependent on the payment of a fee, nor upon the execution of a formal contract. In this case, the trial court found that plaintiffs relied on Attorney Helms to draw up the purchase money note and deed of trust and an expert testified in their opinion an attorney-client relationship existed. The Court of Appeals found sufficient evidence to support the court’s findings that an attorney-client relationship existed. Since an attorney-client relationship existed, defendants owed plaintiffs a fiduciary duty to render their professional services in a skillful and prudent manner. Thus, the Court of Appeals affirmed the trial court.

***Dallaire v. Bank of America, N.A.*, 367 N.C. 363 (2014).**

This case concerns a loan officer’s statements about lien priority in a home mortgage transaction. The Dallaries sued Bank of America for breach of fiduciary duty when refinancing a home loan as the loan officer did not inform the Dallaires of an existing BB&T lien, which was neither paid off nor subject to a subordination agreement. Consequently, the refinancing resulted in BB&T attaining senior priority status on the house, while the new Bank of America loan, which now carried with it personal liability for the Dallaires, took a junior lien position.

On appeal, the Dallaires argued, *inter alia,* that the traditional arm’s length view of borrower-lender relationships does not comport with the modern loan origination and securitization process in which lenders exercise total control over the process and borrowers put complete trust in the lenders. According to the Dallaires, this “new reality” requires a corresponding evolution in the law, whereby lenders should be considered fiduciaries. The North Carolina Supreme Court disagreed.

The Court found fiduciary relationships to exist in certain relationships, including: husband-wife, attorney-client, trustee-beneficiary. However, ordinary borrower-lender transactions or debtor-creditor relationships are considered arm’s length and do not typically establish the existence of fiduciary duties. Rather, borrowers and lenders are generally bound to the Uniform Commercial Code. Nonetheless, because a fiduciary relationship may exist under a variety of circumstances, it is possible for a particular bank-customer transaction to give rise to a fiduciary relation given the proper circumstances such as a special duty owed outside of a contract or the UCC.

***Corwin v. British Am. Tobacco PLC*, 2015 NCBC 3, 2015 NCBC LEXIS 2. (N.C. Super. 2015).**

This opinion arose out of Corwin’s shareholder Class Action Complaint against British American Tobacco (“BAT”), over a transaction among Reynolds American, Inc. (“RAI”), Lorillard, Inc., and BAT, wherein RAI acquired Lorillard. RAI is the second largest tobacco company in the United States. Defendant BAT is RAI’s largest shareholder, holding 42% of its stock. BAT helped fund RAI’s purchase of Lorillard by buying approximately 4.7 billion in RAI stock in order to maintain its 42% ownership of RAI. This action asserted breaches of fiduciary duties of care, loyalty, and candor, and asserted that BAT owed fiduciary duties to RAI shareholders as a controlling shareholder, even though it owned a minority interest in RAI.

Defendants moved to dismiss the Class Action Complaint, with the RAI Defendants alleging that plaintiffs had no standing to bring a claim against them and BAT claiming that it owes no fiduciary duties to RAI shareholders. The issue before the Court was whether BAT, which held only 42% of RAI’s shares and was therefore not a majority shareholder of RAI’s stock, owed any fiduciary duty at all to Corwin and the class of minority shareholders which he was seeking to represent.

As a general rule, shareholders do not owe a fiduciary duty to each other or to the corporation. North Carolina courts recognize an exception to this general rule, so that a controlling majority shareholder may owe a fiduciary duty to minority shareholders. While acknowledging that no prior North Carolina opinion has squarely held that a minority-percentage owner to be a controlling shareholder, Corwin urged that the principles underlying the North Carolina courts’ imposition of a fiduciary duty on the shareholder are dominance and control, and that there are circumstances where a minority owner can exercise such dominance and control. North Carolina courts have not specifically addressed the significance of the percentage of ownership held by the shareholder against whom a breach of fiduciary duty claim is presented. As such, North Carolina courts have not expressly articulated a presumption that a minority shareholder does not have control. But, because Plaintiff did not allege facts sufficient to establish BAT’s dominance or control, which is necessary to impose a fiduciary duty on it as a minority shareholder, the Court granted BAT’s motion to dismiss.

***Green v. Freeman,* 367 N.C. 136 (2013).**

This case arose from a failed corporate venture. The parties include the corporation’s investors and owners. Defendant Corinna Freeman founded Piedmont Southern Air Freight (Piedmont Southern), a shipping company, and ran it until 2001. That same year, Corinna signed a letter “delegating responsibility and authority for making all corporate, financial, operational and administrative decisions for [Piedmont Southern]” to her son Jack Freeman. In 2005, Jack partnered with Larry D’Amelio to create a new shipping company, Piedmont Express Airways (Piedmont Express). Jack and Larry intended to structure Piedmont Express and Piedmont Southern as subsidiaries of a new entity called Piedmont Capital Holding of North Carolina (Piedmont Capital). However, no stockholder or director meetings were ever held, and stock was never issued. And, Corinna did not sign the operating agreements. She did occasionally come to the office to train staff, and was compensated for her time.

Soon after the filing with the Secretary of State, Jack and Larry met with plaintiff Michael Green to discuss investing in this new venture. Afterward, Michael and his brother Daniel, also a plaintiff, each gave the venture $200,000, which they believed would serve as both a loan and an investment. By June 2006, plaintiffs’ $400,000 had all been spent. Checks were signed by Corinna totaling over $19,000 for company expenses. Mortgage and utility payments on a house belonging to Corinna were also paid from the Piedmont Express checking account. In December 2006, plaintiffs sued Jack, Larry, Corinna, and the Piedmont companies to recover the funds. The Green brothers sued Jack Freeman and his mother Corinna Freeman for breach of fiduciary duty, among other things, after their investment failed.

The trial court denied summary judgment for Corinna on plaintiffs’ claims based on breach of fiduciary duty, and the case went to trial. The jury found that Corinna “controlled the companies and that plaintiffs were damaged by her failure to discharge her duty as a corporate director or officer.” Corinna moved for a new trial, but that motion was denied. Corinna then appealed the trial court’s judgment and its denial of her motion for a new trial. The Court of Appeals affirmed the trial court’s denial of Corinna’s motions. The North Carolina Supreme Court reversed and remanded.

On appeal, the issue was whether there was sufficient evidence, as a matter of law, that Corinna breached a fiduciary duty owed to plaintiffs, proximately causing injury to them. “For a breach of fiduciary duty to exist, there must first be a fiduciary relationship between the parties. A fiduciary relationship may arise when there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.” *Id.* at 141.

In North Carolina, directors of a corporation 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. N.C.G.S. § 55-8-30 (2011). When these fiduciary duties are breached, a shareholder may sue the offending director in a derivative action. The general rule is that shareholders, creditors or guarantors of corporations may not bring individual actions to recover what they consider their share of the damages suffered by the corporation. Shareholders may, however, bring a derivative lawsuit against corporate officers and directors, in which case any damages flow back to the corporation, not to the individual shareholders bringing the action.

The plaintiffs here did not bring a derivative suit. Therefore, the Court examined two exceptions to the general rule: shareholders, creditors and guarantors may bring an individual action against a third party for breach of fiduciary duty when (1) the wrongdoer owed them a special duty or (2) they suffered a personal injury distinct from the injury sustained by the corporation itself. Here, Plaintiffs alleged they were both shareholders and creditors.

As mentioned previously, no stock was issued by the Piedmont corporations. Michael Green testified he never received stock and that he did not know whether any stock was put in his name in the company books. Therefore, the Court concluded plaintiffs never became shareholders. However, plaintiffs did allege the $400,000 given to the company was a loan. Thus, the Court considered whether plaintiffs were owed a special duty as creditors. Yet, plaintiffs did not rely on any statement by Corinna about their investment. Corinna never attended meetings and there was no personal interaction between plaintiffs and Corinna. The court held that because they never relied on Corinna or trusted her when they choose to invest, the case did not present facts to establish the recognition of a fiduciary duty under the special duty exception.

To establish a breach of fiduciary duty under the second exception, plaintiffs had to present evidence that they suffered an injury peculiar or personal to themselves. The Court held that there must be evidence that the injury suffered by the creditor is personal and distinct from the injury suffered by the corporation itself. In this case, the loss of an investment was identical to the injury suffered by the corporate entity as a whole. Accordingly, there was insufficient evidence to support plaintiffs’ claim.

**C. When Fiduciary Duties are in Conflict with One Another.**

The most comprehensive summary we found on the issue of conflicting fiduciary duties is Arthur R. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 Am. V. L. Rev. 1, 75 (2004). As Professor Laby notes, many conflicts arise because fiduciaries “act for more than one principal.” Laby, at 81. Trustees administer multiple trusts, lawyers have multiple clients, directors can be on different boards. *See id*. It can be difficult to decide whose interests, if any, the fiduciary should favor. *See id*. At 86. Professor Laby compares five alternative approaches: (1) balancing the interests; (2) subordinating mere property rights to rights that are viewed as more compelling, like constitutional rights to liberty, or privileging property rights over other rights; (3) examining the legitimacy of the purported conflict; (4) deciding which interest existed first; and seeking the view of a neutral third party. *See id*. At 86-98.

Professor Laby also provides a helpful overview of what he regards the chief fiduciary duties: the duty of loyalty and the duty of care. *See id*. At 98-125. Laby defines the duty of loyalty as the responsibility to avoid harming the principal and the duty of care, as a responsibility to act diligently. *See id*. at 109.

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. *Id*. at 103. For instance, in many instances’ fiduciaries are blanketly forbidden from engaging in transactions with principals even for a fair price. *See id*.

With directors and professionals, the duty of care can be quite subjective. However, reviewing materials and monitoring delegated activities can help satisfy the duty. *See id*. at 112. Directors need not have detailed knowledge about all aspects of a corporation – and lawyers need not press every advantage. *See id*. at 115-16. Every lawyer and director will handle things differently – the standard is to focus on *process*, using *prudence*, *reasonableness*, and acting in *good faith*. *See id*. at 117. As the restatement of Trusts notes “Whether the trustee is prudent in the doing of an act depends upon the circumstances as they reasonably appeal to him at the time when he does the act and not at some subsequent time when his conduct is called in question.” Restatement (Second) of Trusts § 174 cmt. b (2004).

For additional reading on fiduciary conflicts, *see* Steven L. Schwarcz, *Fiduciaries with Conflicting Obligations* 94 Minn. L. Rev. 1867.

**D. Breach of Fiduciary Duty Claims and Constructive Fraud Claims, North Carolina Fiduciary Act Defenses.**

***Elements of Breach of Fiduciary Duty and Constructive Fraud***

To prevail on a claim for breach of fiduciary duty, a plaintiff must prove the defendant: (1) owed the plaintiff a fiduciary duty; (2) the defendant breached his fiduciary duty; and (3) the breach of fiduciary duty was a proximate cause of injury to the plaintiff. *Miller v. Burlington Chem. Co., LLC*, 2017 NCBC LEXIS 6, \*23, 2017 NCBC 6 (N.C. Super. Ct. 2017). In North Carolina, a separate but very similar cause of action to breach of fiduciary duty exists called constructive fraud. To prevail on a constructive fraud claim, a plaintiff must demonstrate: “(1) a relationship of trust and confidence, (2) that the Defendant took advantage of that position of trust in order to benefit himself, and (3) that Plaintiff was, as a result, injured.” *White v. Consol. Planning, Inc.*, 166 N.C. App. 283, 294 (2004). “Intent to deceive is not an element of constructive fraud.” *Id.* Moreover, “the primary difference between… a claim for constructive fraud and one for breach of fiduciary duty is the constructive fraud requirement that the defendant benefit himself,” the second element. *Id.* “Wrongful benefit is… an element of constructive fraud and not of a claim for breach of fiduciary duty.” *Id.* The statute of limitations for a breach of fiduciary duty claim is generally three years. *Toomer v. Branch Banking & Trust Co.*, 171 N.C. App. 58, 66 (N.C. App. 2005). However, the limitations period can be as long as ten years if the breach of fiduciary claim can rise to the level of a claim for constructive fraud. *See id.*

***Uniform Fiduciary Act***

Occasionally, a person or entity will attempt to hold a third party liable for the fiduciary’s breach of their duty. For example, a fiduciary, authorized to execute bank transactions on behalf of the principal will execute such transactions that constitutes a breach of their fiduciary duty. North Carolina has adopted the Uniform Fiduciary Act, which relaxes third party liability for the person or entity that performed the transaction at the fiduciary’s request. N.C. Gen. Stat § 32-1, et seq. While the Uniform Fiduciary Act is not tremendously broad, it does impact a few key situations. Perhaps the most relevant portions of the Uniform Fiduciary Act include:

N.C. Gen. Stat § 32-6: If a check or other bill of exchange is drawn by a fiduciary as such, or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, the payee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in drawing or delivering the instrument, and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in taking the instrument amounts to bad faith. If, however, such instrument is payable to a personal creditor of the fiduciary and delivered to the creditor in payment of or as security for a personal debt of the fiduciary to the actual knowledge of the creditor, or is drawn and delivered in any transaction known by the payee to be for the personal benefit of the fiduciary, the creditor or other payee is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the instrument.

N.C. Gen. Stat § 32-7: If a check or other bill of exchange is drawn by a fiduciary as such or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, payable to the fiduciary personally, or payable to a third person and by him transferred to the fiduciary, and is thereafter transferred by the fiduciary, whether in payment of a personal debt of the fiduciary or otherwise, the transferee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in transferring the instrument, and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in taking the instrument amounts to bad faith.

N.C. Gen. Stat § 32-9: If a check is drawn upon the account of his principal in a bank by a fiduciary who is empowered to draw checks upon his principal's account, the bank is authorized to pay such check without being liable to the principal, unless the bank pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing such check, or with knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such a check is payable to the drawee bank and is delivered to it in payment of or as security for a personal debt of the fiduciary to it, the bank is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check.

***Affirmative Defenses***

Just as there is not an exhaustive list of possible causes of action that can arise in fiduciary litigation, there is no exhaustive list of affirmative defenses. Best practice is to assert any possible affirmative defenses in a responsive pleading to avoid inadvertently waiving them. Of the available affirmative defense, the most common include:

*Equitable Estoppel*: Also denominated as “quasi-estoppel” or “estoppel by benefit”, this theory applies when a party accepts a transaction or benefit and then later attempts to take a position inconsistent with the prior acceptance of that same transaction or instrument. *Whitacre P'ship v. BioSignia, Inc.,* 358 N.C. 1, 18, 591 S.E.2d 870, 882 (2004).

*Collateral Estoppel*: *Res judicata* or claim preclusion bars parties from re-litigating matters that were or could have been raised in a prior action between the same parties or those in privity with them. *Brawley v. Elizabeth Townes Homeowners Ass'n,* 2014 N.C. App. LEXIS 920, 4 (2014).

*Laches*: Laches has been defined as such neglect or omission to assert a right, taken in conjunction with lapse of time and other circumstances causing prejudice to an adverse party, as will operate as a bar in equity. Delay which will constitute laches depends on the facts and circumstances of each case, but only applies when the circumstances have so changed during the lapse of time that it would be inequitable and unjust to permit the prosecution of the action. *Young v. Young*, 43 N.C. App. 419, 424, 259 S.E.2d 348, 351 (1979).

*Unclean Hands*: The “clean hands” doctrine prevents recovery in equity where the party seeking relief has engaged in some nefarious conduct that would make an award in their favor unjust. *Crumley & Assocs., P.C. v. Charles Peed & Assocs., P.A.*, 219 N.C. App. 615, 622, 730 S.E.2d 763, 768 (2012).

*Accord and Satisfaction*: An accord is an agreement in which one party undertakes to give or perform, and the other to accept, in satisfaction of a disputed claim which is something other than or different from what the second party considered himself entitled to receive. *Collier v. Bryant*, 216 N.C. App. 419, 436, 719 S.E.2d 70, 83 (2011).

*In pari delicto*: This common law defense arises from the maxim *in pari delicto potior est conditio possidentis* or “in a case of *equal or mutual fault* the condition of the party in possession is the better one.” The law generally forbids redress to one for an injury done him by another, if he himself first be in the wrong about the same matter whereof he complains. Essentially, when both have the same knowledge, willfulness, or wrongful intent and are equally blameworthy, the law will aid the one who is comparatively more innocent. *Commscope Credit Union v. Butler & Burke, LLP*, 2014 N.C. App. LEXIS 1131, 9-10, 764 S.E.2d 642 (2014).

*Contributory Negligence*: Contributory negligence, as its name implies, is negligence on the part of the plaintiff which joins, simultaneously or successively, with the negligence of the defendant alleged in the complaint to produce the injury of which the plaintiff complains. It does not negate negligence of the defendant as alleged in the complaint, but presupposes or concedes such negligence by him. Contributory negligence by the plaintiff can exist only as a co-ordinate or counterpart of negligence by the defendant as alleged in the complaint. *Jackson v. McBride*, 270 N.C. 367, 372, 154 S.E.2d 468, 471 (1967) (citations, internal quotation marks, and emphasis omitted).

*Intervening Negligence*: Intervening negligence of an independent responsible agency may “insulate” the primary negligence charged to a defendant, for example, where such intervening negligence has no logical connection by way of causation with the original negligence, and stands, therefore, independently as the sole proximate cause. *See Montgomery v. Blades*, 218 N.C. 680, 684, 12 S.E.2d 217, 219-220 (1940). In the context of fiduciary litigation, this would most foreseeably arise when one co-trustee files a cross-claim against one or more other co-trustees alleging their negligent mismanagement of trust property was the proximate cause of the plaintiff’s damages.

*Assumption of Risk*: The two elements of the common law defense of assumption of risk are: (1) actual or constructive knowledge of the risk, and (2) consent by the plaintiff to assume that risk. In the context of fiduciary litigation, the crux of such a defense will rest on the level of involvement of the beneficiaries in the investment decisions of the fiduciary. To the extent, for example, the beneficiaries advocate an aggressive, highly speculative investment strategy (and it is not proscribed by the terms and interests of the trust) the trustee may be shielded from liability so long as he adequately educated them on the risks involved and they endorsed the scheme nonetheless. *See Allred v. Capital Area Soccer League, Inc.*, 194 N.C. App. 280, 287, 669 S.E.2d 777, 781 (2008).

*Failure to Mitigate*: This defense precludes recovery for those consequences of the tortfeasor’s act which could have been avoided by acting as a reasonable prudent man. As with other defenses, the burden is on defendant to show plaintiff neglected to mitigate damages. In a negligence action, it is well settled the party wronged must use due care to minimize the loss occasioned by defendant’s negligence. Unlike a plaintiff's failure to establish the element of proximate cause, the failure to mitigate damages is not an absolute bar to all recovery; rather, a plaintiff is barred from recovering those losses which could have been prevented through the plaintiff's reasonable efforts. *See generally Smith v. Childs*, 112 N.C. App. 672, 682-683, 437 S.E.2d 500, 507 (1993) (quotations and citations omitted). This rule is only applicable where the plaintiff could not have reasonably avoided the loss and, for that reason, will be of limited applicability in fiduciary litigation. Since beneficiaries typically have no control over the assets, their ability to mitigate damages from waste or unwise investments will be similarly attenuated in most instances. However, if they sit idly by with full knowledge of the waste or imprudence and refrain from seeking to have the trustee removed for breach of trust or the like, this defense may be available.

*Lack of Standing*: Only interested parties have standing to sue for claims related to a breach of trust, maladministration of an estate, etc. Most often, we think of beneficiaries and heirs as those having standing to sue. However, one co-trustee also has standing to sue another co-trustee to compel him to perform his duties under the trust, enjoin him from committing a breach of trust, or to compel him to redress a breach of trust. *Yost v. Yost*, 213 N.C. App. 516, 521-522, 713 S.E.2d 758, 763 (2011).

***Potential Statutory Defenses for Trustees***

*Reasonable reliance*:A trustee who acts in reasonable reliance on the terms of the trust as expressed in a trust instrument is not liable for a breach of trust to the extent that the breach resulted from the reliance. N.C. Gen. Stat. § 36C-10-1006 (2015).

*Unknown events*: f the happening of an event such as marriage, divorce, performance of educational requirements, or death affects the administration or distribution of a trust and the trustee has exercised reasonable care to ascertain the happening of the event, the trustee will not be liable for loss resulting from a lack of knowledge. N.C. Gen. Stat. § 36C-10-1007 (2015).

*Exculpation Clauses*: A settler can include terms in the trust relieving the trustee of liability for breach of trust (i.e., for conflict of interest); however, exculpation clauses are unenforceable to the extent the breach of trust was committed *in bad faith with reckless indifference* to the purposes of the trust or the interests of the beneficiaries. N.C. Gen. Stat. § 36C-10-1008 (2015).

*Consent, Release, or Ratification*: A trustee is not liable to a beneficiary for breach of trust at the beneficiary *consented to the conduct* constituting the breach, *released the trustee from liability* for the breach, or *ratified the transaction* constituting the breach unless the consent, release, or ratification was induced by *improper conduct of the trustee* or the beneficiary did not have sufficient *knowledge of his rights* or of the *material facts* relating to the breach. No consideration is required for the consent, release, or ratification to be valid. N.C. Gen. Stat. § 36C-10-1009 (2015).

1. The author acknowledges, with thanks, the research and drafting assistance of Carlin G. Robertson, Esq., associate at Terpening Law. [↑](#footnote-ref-1)