Build Your Knowledge – Duty of Loyalty

January 11, 2023

1. **Overview of Fiduciary Duty.** There is a bifurcation of interests, both legal and beneficial, between a trustee and the trust beneficiaries. The trustee, as the holder of the legal title, holds the beneficiaries' beneficial interest in the trust property. The fiduciary duty links the trustee to beneficiaries and is a massive duty that the trustee owes to trust beneficiaries.

2. **Duty of Loyalty.** The trustee must put the beneficiaries' interests above the interests of the trustee at all times and administer the trust solely in the interests of the beneficiaries. The trustee cannot engage in self-dealing, profit from any business dealings with the trust and cannot favor one beneficiary over other beneficiaries.

3. **Reasons for Extent of Duty.** It is difficult for the same person or entity to act fairly in two capacities and on behalf of two interests in the same transaction. The concern is that the trustee may favor the trustee's own interests, consciously or unconsciously, over that of the beneficiaries. Trust relationships also have a confidential nature, and as a result, the beneficiaries may not have the relevant and necessary information to discover disloyal acts on behalf of the trustee.

4. **Breach of Duty.** A trustee breaches the duty of loyalty if the trustee puts his or her personal interests above the trust beneficiaries' interests. While breach of the duty can happen in various ways, the most common violation of the duty is self-dealing.

5. **Remedies for Breach of Duty.** There are various remedies available for breach of the duty of loyalty, including being held liable for normal and appreciated damages, profits, and voiding the transaction. The trustee may also be removed.

6. **Tips for Satisfying Duty.** The trustee should exercise due diligence in administering a trust by knowing who the beneficiaries are, what the trust document allows and prohibits, and understanding the intent of the grantor. The trustee can obtain consent of the beneficiaries for actions as trustee and request court approval for its actions. The trustee should communicate regularly with beneficiaries and keep clear and detailed records.

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1. **Overview of Fiduciary Duty.**
   a. There is a bifurcation of interests, both legal and beneficial, between a trustee and the trust beneficiaries. The trustee, as the holder of the legal title, holds the beneficiaries' beneficial interest in the trust property.
   b. A beneficial interest is the right to receive benefit from assets held by the trustee.
   c. The fiduciary duty links the trustee to beneficiaries and is a massive duty that the trustee owes to the trust beneficiaries.
   d. The fiduciary duty is primarily composed of the duty of loyalty and the duty of prudence but also includes various sub-duties.

2. **Duty of Loyalty.**
   a. Rule: The trustee must put the beneficiaries' interests above the interests of the trustee at all times and administer the trust solely in the interests of the beneficiaries.
   b. To satisfy the duty, the trustee: (1) must not engage in any self-dealing; (2) must not profit from any business dealings with the trust; and (3) cannot favor one beneficiary over other beneficiaries.

3. **Reasons for Extent of Duty.**
   a. It is difficult for the same person or entity to act fairly in two capacities and on behalf of two interests in the same transaction.
   b. The trustee may favor the trustee's own interests, consciously or unconsciously, over that of the beneficiaries.
   c. Trust relationships have a confidential nature.
   d. The beneficiaries may not have all relevant and necessary information to discover disloyal acts on behalf of the trustee.

4. **Breach of Duty.** A breach of the duty of loyalty can happen in various ways, including the following:
   a. Purchasing of trust property by trustee individually.
   b. Selling of trustee's individual property to himself or herself as trustee.
   c. Borrowing or lending from the trust.
   d. Using trust property for trustee's own purposes.
   e. Participating in certain transactions by corporate trustee in its banking department.
   f. Purchasing from third party of an adverse interest.
   g. Receiving excessive bonus, commission or other compensation.
   h. Performing specialized work for the trust.
   i. Competing with the beneficiary.

5. **Remedies for Breach of Duty.**
   a. The trustee can be held liable for normal damages and appreciated damages.
   b. The trustee can be held liable for any profit made through the breach.
   c. The beneficiary may recover from trustee a profit that would have accrued in the trust if there had been no breach.
   d. The beneficiary may void transaction.
   e. The trustee may be removed.
   f. Fees incurred by the trustee might become a personal obligation of the trustee.

6. **Tips for Satisfying Duty.**
    a. The trustee can obtain consent of the beneficiaries. Note, the trustee's action may still be voidable if the trustee failed to disclose materials facts, used a position of influence to obtain consent or the transaction was unfair and/or unreasonable.
    b. The trustee should exercise due diligence by knowing who the beneficiaries are and how to contact them, knowing the trust document and understanding the intent of the grantor.
    c. The trustee should communication regularly with the beneficiaries and keep clear and detailed records.
    d. The trust agreement, statutes, settlor or court may authorize and/or approve the transaction.
    e. The trustee should disclose any conflicts of interests with the beneficiaries.

7. **Case Study.**
    a. Farmer 1 appoints Farmer 2, who is a neighbor, as successor trustee of his revocable trust.
    b. Farmer 1 rents his land to others who plant crops.
    c. Farmer 1 dies in January and Farmer 2 accepts his role as trustee.
    d. Farmer 2 discovers that Farmer 1 lost his primary tenant, so he decides to farm the land paying fair market value rent to the trust.
    e. Finding: Farmer 2 breaches his duty of loyalty, is removed as trustee and is forced to disgorge his profits.

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