COMMON LAW AND STATUTORY FIDUCIARY

We are accustomed to thinking of “Fiduciary in statutory terms, which actually refer to “Investment Fiduciary”. We see it codified in Federal and State laws. However, fiduciary responsibility extends far beyond that required of investment fiduciaries; indeed it extends to virtually all business dealings. Its evidence is in the vast body of case law known as “Common law”
The common law fiduciary principles outlined below dictate entities’ duties owed to shareholders, employers, business partners and customers. While an entity has potential liability for a breach of its fiduciary responsibilities in all its actions, there will exist slight variances in the standards of care of such responsibility, which various courts may apply.

THE NEW FIDUCIARY

The word, Fiduciary," has taken on an expanded meaning in the past few years. Accusations of corporate misdeeds and mutual fund favoritism amid declining shareholder values have caused investors to be more attentive to the question, "Who owes fiduciary responsibility to whom, and for what?" Yet, the basic principles are not really new. Beginning with English common law definitions, Federal and State laws discussed below have adopted and refined fiduciary responsibility with respect to investing the assets of other parties over many years. While standards of care may vary depending on the legal venue, fiduciary responsibility has a common thread seen in its application.

A. Fiduciary in Common Law

Fiduciary principles have been used for centuries in English Common Law (and employed by American courts) which show an extensive non-statutory law reflecting precedent derived from perhaps centuries of judges hearing real cases.

Common Law defines a fiduciary relationship as one defining a legal relationship between the parties. It imposes the highest standards of care employed in courts of equity or law, it embodies good faith, loyalty and trust, and it includes the following duties:

1. A legal duty to a principal (the other party)
2. Absolute loyalty to the other party
3. Personal interests may not be put before that loyalty
4. Parties may not profit from their positions as fiduciaries
5. <u>Not</u> to be in a situation where personal interest and fiduciary duty conflict
6. <u>Not</u> to be in a situation where their fiduciary duty conflicts with another fiduciary duty
7. A duty not to profit from their fiduciary position without the express knowledge and consent of all parties concerned

8. A duty to avoid conflicts of interest

B. Statutory Investment Fiduciary

Three principal laws that govern statutory investment fiduciary responsibility are ERISA, the UPIA and UMIFA. They are similar, with some nuances unique to each.

They all determine fiduciary duty by beginning with a look at documents. Employee benefit plans, private trusts, endowments and foundations all have documents, including investment policy statements which identify to whom the assets belong, whether it be individuals, families, 401(k) participants, or trust beneficiaries. All investment and administrative decisions MUST be made in consideration of that asset owner's facts, circumstances and wishes.

Any investment program must be prudently structured to meet those needs. Every pool of assets should have written investment objectives that reflect the financial goals of the investors. Investment alternatives and strategies suitable to those investor needs are the only ones permissible. Investments have to have sufficient diversification to satisfy the investors' risk tolerance.

For example, in, In Re Masters, Mates and Pilots, (957 F 2d, 1020) trustees were fined $74,000 for having all $9 Million of the plan assets in a local bank, paying slightly below market CD rates. The court said it was "too much risk" for the beneficiaries.

Investments must adhere to prudent standards. A prudent investment process is one in which investment decisions are made solely in the interest of the investors, free from any conflicts of interest, and which has an ongoing review component where economic changes or changes in the financial condition of the investors can be reflected in reallocations or adjustments.

A key case that established the prudence standards later incorporated into ERISA and the State laws was the 1971 decision in:

Blankenship v. Boyle (329 F.Supp., 1089) where trustees of the United Mine Workers were found to have breached their fiduciary responsibilities by directing retirement trust funds to be invested in electric utility companies in order to give the Union proxy control, forcing the utilities to buy Union mined coal. Even though the beneficiaries' interests were clearly served because retirement contributions were directly related to Union mined coal, the trustees' investment activities were found to clearly advance the Union's interests first.

Another common thread in all the legal fiduciary provisions is that personal liability extends to any person or entity found to have breached or otherwise violated their fiduciary duty. They will be liable personally to restore lost profits, and will be liable for the acts of a co-fiduciary.

An example of the liability burden is found in, ***Dardaganis v. Grace Capital*, where Grace, the money manager, ignored the trustee's refusal to raise the percentage limitation on investments, and exceeded that limitation. Grace was found personally liable for failure to oversee and manage the portfolio according to the stated investment objectives.**

State Laws: UPIA/UMIFA

Most states have adopted the Uniform Prudent Investor Act (UPIA) which govern investments of private trusts and the delegated agents who invest or manage trust assets. It generally mirrors ERISA but applies somewhat lower standards of fiduciary care.

Investments must be solely in the interest of beneficiaries, and must be diversified unless the trustee reasonably determines that because of "special circumstances" the purposes of the trust would be better served without diversifying. Assets must be invested as a "prudent investor" would by exercising reasonable care, skill or control.

Currently under revision, the Uniform Management of Institutional Funds Act (UMIFA) governs the investment practices of endowments and foundations and applies slightly lower standards of care than the UPIA.

Fiduciaries must exercise "ordinary business care and prudence" under the facts and circumstances prevailing at the time. The institution's board remains responsible for the establishment of investment policies and the selection of competent agents.