

THE CLASH OF BUSINESS FIDUCIARY DUTIES WITH OTHER DUTIES

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Legal Duties

- What are legal duties?
 - Your obligations to others and their obligations to you.
 - What you can sue for and what you can be sued for.
 - What you can be prosecuted for.

Legal Duties

➤ Where do legal duties come from?

Constitutions, statutes, regulations, ordinances, treaties, case law, and contracts.

➤ Where do fiduciary duties come from?

Common law, statutes, trust agreements, certificates of formation, LLC company agreements, partnership agreements, etc.

Objective vs. Subjective Standards

- Objective standard -- the reasonable person construct asks “what would a reasonable person do in these circumstances?” This is “ordinary care” or the care of a “reasonably prudent investor”.
- Subjective standard -- delves into the cognition of the actor - her mental state. Did she intend harm? Did she knowingly disregard a substantial risk of harm? Did she act in good faith?
- Mixed standard -- has a component that is objective and a component that is subjective. For example, “reasonably believed.”

Mental States (Criminal)

- **Intentional** -- “a conscious objective or desire to engage in the conduct or cause the result.”
- **Knowing** – “aware of the nature of his conduct or that the circumstances exist,” and “aware that his conduct is reasonably certain to cause the result.”
- **Reckless** – “aware of but consciously disregards a substantial and unjustifiable risk that the circumstances exist or the result will occur.”
- **Criminally Negligent** – “ought to be aware of a substantial and unjustifiable risk that the circumstances exist or the result will occur.”

Mental States (Tort)

- **Intent** – “the actor desires to **cause the consequences** of his act, or ... believes that the consequences are **substantially certain** to result from it”.
- **Reckless** – “knowing or having reason to know of facts which would lead a reasonable man to realize, not only that his conduct creates an **unreasonable risk** of physical harm to another, but also that such risk is **substantially greater** than that which is necessary to make his conduct negligent”.
- **Negligent** – “conduct which falls **below the standard** established by law for the protection of others against unreasonable risk of harm”.
- **Malice** (exemplary damages) -- outrageous, malicious, or otherwise **reprehensible conduct** with **intent** for the victim to **suffer injury different from** the underlying cause of action.⁶

Business-Related Crimes (Texas Law)

- Hindering Secured Creditors
- Deceptive Business Practices
- Commercial Bribery
- Misapplication of Fiduciary Property
- Fraudulent Destruction, Removal, or Concealment of Writing

Business-Related Crimes (Federal Law)

Obstruction of Justice

- Witness tampering and retaliation
- Obstructing examination of a financial institution
- Destroying, altering, or falsifying records w/ intent to impede investigation
- Destroying corporate audit workpapers

Racketeer Influenced and Corrupt Organizations (RICO) Act

- Participating in an ongoing criminal organization

Mail and Wire Fraud

- Using mail or wire to defraud; “honest services fraud” limited to bribes/kickbacks in *Skilling v. U.S.* (2010)

Foreign Corrupt Practices Act of 1977

- Prohibits payment of bribes to foreign officials to obtain or retain business

Duties Under Federal Securities Laws

- Securities Act of 1933 (initial public offerings): untrue statement of material fact or failure to state a material fact that would make a statement made not misleading.
- Securities Exchange Act of 1934 (resale): created SEC; untrue material disclosure and non-disclosure; insider trading.
- Investment Advisors Act of 1940: registration; fiduciary duties.
- Sarbanes-Oxley Act of 2002: board audit committee w. financial expert; CEO sign financial statement; attorney's duty to disclose.
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010: fiduciary duty broker-client; whistleblower bounty program.
- Mental States: willful, knowing, (possibly) negligent.

Business Torts

- Fraud
- Negligent Misrepresentation
- Business Disparagement
- Texas Theft Liability Act
- Liability of agents, including corporate officers, for their own acts

Fraud

- 1) A **material representation**;
- 2) That was **false**;
- 3) The speaker **knew** at the time that it was false or made it **recklessly** without any knowledge of the truth and as a **positive assertion**;
- 4) Made with the **intent** that the other party should act upon it;
- 5) The party did act in **reliance** on the representation;
and
- 6) The party thereby suffered **injury**.

Fraud (cont.)

- “Pure expressions of opinion are not representations of material fact, and thus cannot provide a basis for a fraud claim.”
- “Material means a reasonable person would attach importance to and would be induced to act on the information in determining his choice of actions in the transaction in question.”

Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am. (341 S.W. 3d 323, 335-338 Tex. 2011)

Negligent Misrepresentation

A person who --

1. in a **business**, professional, employment, or pecuniary transaction,
2. **negligently**
3. supplies **false information** to another
4. who **justifiably relies** on it

is liable for pecuniary loss.

Must be supplied to a **known party** for a **known purpose**.

Vicarious Liability of Principal

- Respondeat Superior
- Aiding and Abetting
- Conspiracy?

Direct Liability of Principal

- Misrepresentation
- Defamation
- Negligence (if there is a duty)

Personal Liability of Agents

“A bedrock principle of corporate law is that an individual can incorporate a business and thereby normally shield himself from personal liability for the corporation’s contractual obligations. Avoidance of personal liability is not only sanctioned by the law; it is an essential reason that entrepreneurs like Willis choose to incorporate their businesses.” *Willis v. Donnelly* (Tex. 2006).

In *Spicer v. Maxus Healthcare Partners, LLC*, No. 02-17-00449-CV (Tex. App.—Fort Worth Oct. 1, 2020, n.p.h.), the court held that the president of a corporation could be held liable for his own fraudulent statements, even though he was acting in his capacity as president of an LLC.

COMPARING THREE TYPES OF RELATIONSHIPS

Formal Fiduciary Relationships

Agent → Principal

Trustee → Beneficiary

Attorney → Client

Guardian → Ward

Administrator/Executor → Devises

Partner → Partner/Limited Partners/Joint Venturers

Corporate Directors/Officers/Managers → Company/
Owners/Creditors

Executive Rights Over Mineral Interests

Spouse → Spouse

Parent → Child

Informal Fiduciary Relationships

1. “[W]here one person trusts in and relies upon another, whether the relation is a moral, social, domestic, or merely personal one.” *Fitz-Gerald v. Hull* (Tex. 1951)
2. In those cases “in which influence has been acquired and abused, in which confidence has been reposed and betrayed.” *Texas Bank & Trust Co. v. Moore* (1980)
3. “A relationship of trust and confidence.” PJC 104.1
4. “[T]he existence of a confidential relationship is ordinarily a question of fact.” *MacDonald v. Follett* (Tex. 1944)

Arm's-Length Transactions

- “[T]he civil courts of Texas have generally held that everyday arms-length business transactions, including contracts to sell goods and services, do not give rise to a fiduciary relationship between the parties.” *Berry v. State* (Tex. Crim. App. 2014).
- “The fact that one businessman trusts another, and relies upon his promise to perform a contract, does not rise to a confidential relationship.” *Crim Truck & Tractor Co. v. Navistar Int’l Transp. Corp.* (Tex. 1992).
- “[A]ll contracting parties presumably contract for their mutual benefit.” *Schlumberger Tech. Corp. v. Swanson* (Tex. 1997).

Defining Fiduciary Duties

- Texas Pattern Jury Charges
- Duty of Loyalty
- Duty of Good Faith
- Duty of Care
 - Ordinary Care
 - Prudent Investor Standard
 - The Business Judgment Rule
- Duty of Disclosure
- Prohibition Against Self-Dealing

Texas Pattern Jury Charges

PJC 104.4, Fiduciary Duty

1. Was the transaction fair and equitable?
2. Was there reasonable use of confidence?
3. Utmost good faith and most scrupulous honesty?
4. Put beneficiary's interest first (no self-dealing)?
5. Full disclosure of all important information?

Duty of Loyalty

Agent: to act solely for the benefit of the principal within the scope of agency.

Trustee: invest and manage assets “solely in the interest of beneficiary”. Tex. Prop. Code § 117.007

Corporate: directors and officers must act in good faith; personal interests cannot prevail over interests of corporation.

Partnership: accounting for partnership property; refrain from dealing on behalf of others with interest adverse to partnership; refrain from competing or dealing in a manner adverse to partnership.

Duty of Good Faith

Trustee: must administer trust in good faith in accordance with the trust instrument and the Property Code.

Attorney: Utmost good faith.

Corporation: Discharge duties in good faith (but not up to the standards of a trustee).

Partnership: “Obligation” to act in good faith.

Duty of Care

Trustee: Invest and manage assets “prudently”; use “reasonable care, skill and caution”.

Executor: Use care of a prudent person; use ordinary diligence to collect debts.

Attorney: Use care of a reasonably prudent attorney (duty owed only to client, not third parties).

Corporation: Use ordinary care.

Partnership: Use care of an ordinarily prudent person.

Duty of Disclosure

Arm's-length: No duty except to rectify an inaccurate partial disclosure or a prior disclosure that has become inaccurate.

Fiduciary: strong duty to disclose.

Trustee: duty of full disclosure of all material facts known to trustee that might affect the beneficiary's rights.

Attorney: Keep client reasonably informed (TDRPC Rule 1.03)

Publicly-traded corporations: no material misrepresentation in public announcements or financial statements; no omission of information necessary to make a disclosure not misleading.

ERISA trustee: No general duty to provide individualized, unsolicited advice.

Insider Knowledge: If not disclosed, cannot buy or sell based on insider knowledge.

No Self-Dealing

Agent: Must account to principal for profits.

Trustee: No loans, purchases, or sales to trustee or related parties (unless allowed by trust instrument); don't commingle trust funds with trustee's funds.

Guardian: No personal transactions with the ward's estate.

Attorney: No commingling of client's funds.

Corporation: No insider trading in publicly-traded corporations; corporate opportunity doctrine; loans to directors and officers are voidable.

FIDUCIARY DUTIES ARISING FROM DIFFERENT RELATIONSHIPS

Agent-Principal

- The agent-principal relationship is the framework for many fiduciary duties.
- Including partners, corporate officers, employees.
- Agent owes 100% loyalty within the scope of the agency.
- The principal, not the agent, is liable to third parties (caveat: liability is sometimes imposed).
- Profits improperly taken by the agent can be disgorged.

Trustee of Express Trusts

1. Statutory Duties and Prohibitions

- Duty of Good Faith, subject to statutory rules, common law, and trust agreement, TPC § 113.051
- Duty of Care, TPC § 117.003(a)
- Duty to Diversify, TPC § 117.005
- Duty of Loyalty, TPC § 117.007
- Duty of Impartiality, TPC § 117.008

Trustee of Express Trusts

2. Common Law Duties

- Subject to statute; subject to trust instrument
- Duty of care, skill, prudence, and diligence ordinarily prudent man with similar business and similar objectives. *Varsity Corp. v. Howe*, 516 U.S. 489, 497 (1996)
- No duty to violate law

3. Duties under of the trust document

4. Trustee's discretion

BUSINESS ENTITIES

What Law Applies?

Internal Affairs Doctrine, TBOC §1.101 & §1.102.

Internal Affairs -- “rights, powers, and duties of its governing authority, governing persons, officers, owners, and members” and “matters relating to its membership or ownership interests.” TBOC §1.105.

Choice of law clauses are enforced.

Most Significant Relationship standard for substantive claims (e.g., involving outsiders).

Law of the forum applies to procedural matters.

Directors/Officers: For-Profit Corporations

- Duty of Obedience
- Duty of Care
- Duty of Loyalty
- Reliance on others
- Duties to creditors
- Environmental, Social, and Governance (ESG)
 - Global Warming/Climate Change
- Lack of oversight
- Executive misconduct (inside and outside company)
- Liability to third parties

General Partnerships

Duty of Loyalty, TBOC § 152.205

Duty of Care, TBOC § 152.206(a)

Obligation of Good Faith, TBOC § 152.204(b)

Breach of Partnership Agreement or Statutory
Duty, TBOC § 152.210

No duty to remain partners, *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545 (Tex. 1998)

Limited Partnerships

General Partner: Duties of loyalty, care, good faith.

Limited Partner: no duties except possibly loyalty; full duties if assumes management.

Informal fiduciary relationships can exist between partners that create common law duties.

The **partnership agreement** can create contractual duties or alter statutory or common law fiduciary duties.

Duties in Business Transactions

1. Arm's-Length
2. Formal Fiduciary Relationships
3. Informal Fiduciary Relationships
4. Fraud
5. Negligent Misrepresentation
6. Warranties
7. Deceptive Practices
8. Merchants

Contractual Relationships

1. The terms of the contract control
2. Fraud in the Inducement
(Disclaimer of Reliance)
3. Breach of Contract
4. Injury determines contract or tort
5. Willful breach of promise is not a tort

Contractual Relationships

6. Implied contractual duty of Good Faith and Fair Dealing in special relationships
7. Implied Covenants arising from contract
8. Preexisting fiduciary relationships between contracting parties
9. Third-party beneficiaries
10. Tortious Interference with contract or prospective business relations

Employer to Employee

➤ At-Will Employment

➤ Employers' Duties to Employees

Safe Working Environment

Unlawful Employment Practices:

Racial Discrimination

Equal Pay

National Origin

Family Medical Leave

Gender Discrimination

Hostile Work Environment

Age Discrimination

Overtime

Retaliation

Disabilities

Employee to Employer

- Employee's must act primarily for the benefit of the employer.
- Protect trade secrets; don't solicit employer's customers or current employees while still working there; do not remove confidential information.
- Employee can plan to compete
- Covenant Not to Compete

Reporting Wrongdoing

Whistleblowers

- Federal Law
- Texas law

Qui Tam Litigation

Attorney to Client

- **Ethical Duties:** zealous representation; competent and diligent representation; keep client reasonably informed; no unconscionable fee; confidentiality; no conflicts of interest; safekeep client's property.
- **Contractual duties** are in the employment agreement.
- **Tort** duty of ordinary care.
- **Privity** limits duties to third parties.
- **Attorney immunity** for conduct engaged in while representing a client.
- **Absolute privilege** for statements in court proceedings.

Accountants and Auditors

- Are accountants fiduciaries?
- Auditors owe a fiduciary duty to the public.
- Auditing Standards.
- Auditors' Negligence.
- Problems in the Auditing World.

ERISA Plan Trustees

- Prohibited transactions with “party at interest”
- Duty of Loyalty - act solely in the interest of plan participants
- Duty of Care - prudent man standard (including duty to diversify)
- Duty to Disclose - upon request; w/o request is uncertain
- Exculpatory Provisions (but can't waive ERISA standards)
- Insider information

ERISA Plan Trustees (ESOP)

- Prohibited Transactions
- Duty of Loyalty
- Duty of Care (but not to diversify)
- Duty to Disclose
- Exculpatory provisions
- Insider information

The Duty to Preserve Information

- Arthur Anderson
- Martha Stewart
- Volkswagen
- Spoliation

Duty to preserve arises when the party knew, or should have known, of a substantial chance there would be litigation and that the evidence would be material to it

Remedies for Breach of Fiduciary Duty

- Rescission
- Damages
- Unjust Enrichment
- Disgorgement
- Injunction
- Receiver
- Constructive Trust

Non-Discharge in Bankruptcy

- Obtaining money, property, services or credit
(A) through false pretenses or representations, or actual fraud, other than a statement of financial condition, or
(B) through a materially false written statement regarding financial condition, published with the intent to deceive and reasonably relied upon. Bankruptcy Code § 523(a)(2).
- “Fraud or defalcation while acting in a fiduciary capacity.” Section 523(a)4.

EXAMPLES

Necessity and Justification

Necessity: A hiker on a mountain is caught in a storm. She enters an unoccupied cabin and eats some food and burns some wood, thereby saving her life. Under the defense of necessity, the hiker is not guilty of the crime or liable for the tort of trespass, but she must pay for the value of the food and wood she used.

Agent and Principal

A real estate broker agrees to help a client purchase a house in a particular neighborhood. There are number of houses that could meet the client's desires, several that are listed for sale by the broker and several that are not.

The broker gets a 6% commission if the client buys a house he has listed, but only 3% if the client buys a house listed with another broker.

The broker shows the client only houses listed by his office. Is this a breach of fiduciary duty? "Yes." Damages? "Hard to prove." Disgorgement? "Possibly."

Trustee Transacts With Beneficiary

The trustee of an express trust invests trust funds in a business start-up in which he is the only other investor. The action is not mentioned as a permitted transaction in the trust agreement. Is this a breach of fiduciary duty?

“Probably.”

If the investment loses money, the trustee will likely have to make the trust whole.

If the investment makes money, the trustee may be made to disgorge some or all of his profits.

Trustee's Duty to Diversify

The trustee of an express trust invests 50% of the trust assets in Tesla Inc. and 50% in cash.

Has the Trustee violated his duty to diversify under Tex. Prop. Code §117.005?

“Possibly.” If the Tesla stock goes up and the trustee sells for a big gain, he is a hero. If Tesla stock goes down and the trustee sells for a big loss, he may be sued for failure to diversify.

Trustee's Duty to Sell

A new U.S. President has been elected. He ran on a campaign to double the capital gain tax.

The same party may control both houses of Congress, making a tax increase more likely.

Should the trustee of a private trust liquidate assets with large built-in capital gains before year-end?

Should an investment advisor recommend liquidation? What if their company earns a broker's commission on sales?

Duties of Corporate Directors and Officers

Duty of Obedience (no ultra vires acts)

Duty of Care (a negligence standard)

Duty of Loyalty (corporate opportunities; self-dealing)

Reliance on Others (TBOC § 3.105)

Duties of Corporate Directors and Officers

Directors must act in good faith, with ordinary care, and in a manner the director reasonably believes is in the best interest of the corporation. TBOC § 22.221(a).

To be held liable, a director must violate all three duties at the same time. TBOC § 22.221(b).

But directors are not held to the duties of a trustee. TBOC § 22.223.

The same three-part test applies to officers. TBOC § 22.235.

Partner's Obligation of Good Faith

A partner in a real estate partnership steers the partnership toward borrowing money from a bank of which he is a part-owner and a member of the board of directors. The terms are similar to what could be obtained from other lenders.

Is this a breach of the partner's duty of loyalty or obligation of good faith?

“No.” The partnership was not harmed. “A partner does not violate a duty or obligation under this chapter or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.” TBOC §152.204(c).

Contracts with Corporate Officers

A closely-held corporation owns several pieces of real estate.

One director is a licensed real estate broker. The Board decides to list three of the properties for sale with this director. The properties are marketed and sold for the standard brokerage fee and a good price.

A minority shareholder threatens to sue for the director to return his commission. What happens? “It depends.”

Under TBOC § 22.230, contracts with directors and others are OK if disclosed to the board and a majority of disinterested directors vote to approve the contract, in good faith and with ordinary care, or if the contract is fair to the corporation.

If those criteria are not met, the director must prove fairness.

LLC as a General Manager

John is the sole manager of an LLC that is the general partner of a limited partnership.

The fiduciary duties that John owes to the LLC are governed by LLC law, while the duties John as manager of the general partner owes to the partnership and other partners are governed by partnership law.

Hopefully, these duties will never conflict. If they do, which prevails?

Because the LLC is a general partner and owes fiduciary duties to the partnership, the partnership duties should come first.

When a Corporation is Insolvent

When a corporation is insolvent and has ceased normal business, the directors cause the corporation to pay loans due to shareholders without paying outside creditors first.

What are the creditor's remedies?

Fraudulent transfer; trust fund theory; TBOC § 22.226.

Privacy of Health Information

Personal health information is generally considered to be private information.

An employee in an office tests positive for COVID-19.

DHHS has issued guidelines about disclosure of the identity of COVID-positive persons to first responders, without mentioning disclosure to co-employees.

The employer has a duty to provide a safe workplace. The better approach is to disclose that an unnamed employee tested positive.

The illness must be recorded and reported to OSHA if it was contracted at work.

Executive Rights Over Minerals

James holds executive rights over his mineral interests as well as the mineral interests of other royalty owners in the same property. James also owns the surface rights to the property, including the water rights.

The primary term of the oil and gas lease is rapidly approaching and no drilling has begun. James agrees to extend the primary term in exchange for the operator's agreement to buy water from his wells at above-market rates.

Does this breach the executive's fiduciary duty to the other royalty owners?

"Yes." James didn't secure an equal benefit for the other royalty owners.

Environmental, Social & Governance

You are advising the Board of Directors of a privately-held corporation. Some shareholders are not board members.

Some directors want to adopt a policy that the corporation will buy only electricity identified as coming from renewable energy sources, even though that costs appreciably more than ordinary electricity.

Would that policy breach any of the Board's duties to the corporation?

Directors must act in a manner that they reasonably believe is in the best interest of the corporation. TBOC § 22.221(a). But directors are liable only if they do not act in good faith, **and** do not use ordinary care, **and** do not act in a manner they reasonably believe is in the best interest of the corporation. TBOC § 22.221(b).

Spouse's Duties Regarding Community Property

The husband has sole management and control over his salary and bonuses, which are community property.

The husband transfers half of a large bonus to his girlfriend. In the divorce, the wife sues to recover the gift based on actual and constructive fraud on the community.

Can the wife sue the girlfriend for the return of the money?

The law is not crystal clear. Most likely the wife must first seek compensation out of the community estate or the husband's separate property, and if that is inadequate then seek to invalidate the transfer to the girlfriend as a fraudulent transfer or by imposing a constructive trust. *Chu v. Hong* (Tex. 2008).

Attorney Representing a Trustee

You are hired by the trustee of an express trust to defend the trust in litigation.

One of the trust beneficiaries calls you saying that she disagrees with trustee's intention to settle the case by paying a substantial sum to the plaintiff. The beneficiary asks you not to go forward with the settlement. You talk to the trustee who is determined to settle.

What do you do?

Do what the trustee wants. The trustee is your client.

Huie v. DeShazo, 922 S.W.2d 920, 925 (Tex. 1996).

Attorney for the Executor of an Estate

You are the attorney for the independent executor of a decedent's estate.

One of the beneficiaries under the will calls complaining about the executor's bias against her, and asks you about private conversations you had with the executor about the estate.

Can you reveal your discussions with the executor?

“No.” Your conversations with the executor are subject to the attorney-client privilege. *Huie v. DeShazo*, 922 S.W.2d 920, 923 (Tex. 1996).

Drafting a Demand Letter That Could be Defamatory

You are drafting a demand letter in a case alleging misapplication of fiduciary property, which is an offense under Penal Code § 32.45(b). Your letter is accusing the other party of committing a crime.

Are you at risk of being held liable for defamation?

“No.” Attorneys are immune from civil liability to non-clients for actions taken in connection with representing a client in litigation. *Cantey Hanger, LLP v. Byrd*, 467 S.W.3d 477, 481-82 (Tex. 2015).

Section VIII.D.1.f

Pleading Claims That Could be Defamatory

You are drafting a pleading in a case alleging misapplication of fiduciary property, which is an offense under Penal Code § 32.45(b). You are accusing the defendant of committing a crime.

Are you or your client at risk of being sued for defamation?

“No.” Every participant in a court proceeding has an absolute privilege against being sued for libel or slander for what they say in court.

Section V.C.4

Opinion Letter To Third Party

You draft a letter for a corporation saying that taking out a loan has been ratified by the board of directors and is in compliance with the corporate charter and by-laws. You say this in reliance on what the corporation's CEO told you. The letter is submitted to a bank in support of the loan.

Turns out that the CEO did not obtain the required board approval of the loan. The loan goes into default, the bank sues and the corporation pleads that that the loan was an ultra vires act. The bank joins you in the suit claiming negligent misrepresentation. Can you be held liable? "Yes."

Section VIII.I.3

Reporting a Law Partner's Suspected Overbilling

You are a junior partner in a law firm. You suspect your supervising partner on a particular case is overbilling. You report this to the senior partner. Turns out the client is not being billed for the excess time. You are expelled from the partnership. What recourse do you have?

“None.” *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545-46 (Tex. 1998) (there is no duty to remain partners).

Duty to Report Neglect or Abuse of a Child

An attorney learns in representing a client that a child in the client's family likely was a victim of child abuse by another person. Under Tex. Disc. Rule of Prof. Conduct 1.05(c)(4), a lawyer can reveal confidential client information when the lawyer has reason to believe it is necessary to do so in order to comply with the law.

“A person having cause to believe that a child's physical or mental health or welfare has been adversely affected by abuse or neglect by any person shall immediately make a report as provided by this subchapter.”

Tex. Fam. Code § 261.101

Insider Trading

Your law firm is representing a publicly-traded company. You see non-public information that will move the stock price up when it is announced. You quickly buy stock in the company. When the information becomes public, the price rises and you sell, making a tidy profit. If caught, you will disgorge your tidy profit. You may go to prison.

Section IV.B.2

ERISA Plan Trustee With Insider Knowledge

You are an ERISA plan trustee. You acquire insider knowledge that once made public will cause the stock price to drop. Can you sell the stock held by the Plan? “No.” You have no duty or privilege to violate Federal Securities laws. This is true for ESOP trustees as well.

If you trade on insider information, it is a crime, even if you do it for the benefit of others.

Registered Investment Advisor

Investing in Mutual Funds

Under the Investment Advisor Act of 1940, registered investment advisors have a fiduciary duty to the client.

Your company's policy is to invest in mutual funds that charge an entrance fee and pay a commission. No-entrance-fee funds are available.

The law requires the advisor to disclose the no-fee option to the customer. This goes against company policy. What do you do?

Advise the client of the choice, and if they specify the no-fee investment, do what the client wants. If you are blackballed, leave the company. If you get fired, think about reporting it to the SEC.

Section IV.C

Investment Advisor Forwarding Investments to Other Advisors

Under the Investment Advisors Act of 1940, investment advisors cannot engage in a transaction that is fraudulent, deceptive or manipulative.

Some investment advisors forwarded funds entrusted to them to Bernie Madoff, who returned an unusually high rate of return on funds invested with him.

Some of the forwarding fund managers did not inform their clients of the forwarding, and did not exercise due diligence in investigating Madoff's operation.

The high rate of return led to loss of the invested funds. The forwarders were seemingly negligent, and the ones who did not disclose the forwarding were seemingly both negligent and deceptive.

Executive's Improper Relationship With Employee

Federal and state laws require employers to take prompt remedial action to eliminate a hostile work environment.

For years, some CEOs got away with improper sexual relationships with employees with no adverse consequences to the CEO. This often required Directors to turn a blind eye to the behavior.

More recently, CEOs have been fired or asked to resign for sexual misconduct with employees. Formerly CEOs often left with large severance packages. More recently some companies have been firing their CEOs for cause, which put their severance benefits at risk.

Some directors are beholden to the CEO for their Director position, but the Directors owe the corporation a duty of good faith and ordinary care and must put the best interest of the corporation first.

Executive Misconduct (Publicly-Traded Company)

It emerges that the CEO of your company has engaged in improper sexual relationships with employees over a long period of time. The company is threatened with a sexual harassment lawsuit, and you fear that once one is filed, more will follow.

The Board can let the CEO retire quietly with \$40 million in severance benefits, or the Board can fire him for cause and pay no severance benefits. It is expected that the CEO, if denied benefits, would sue the company, putting this past in the news, perhaps causing a consumer boycott or a drop in the company's stock price.

How should the Board exercise their fiduciary duty to the company: quiet dismissal with benefits, or dismissal with cause and no severance benefits? Remember that a hostile work environment claim will likely be filed, with attendant publicity.

Executive Private Misconduct (Privately-Held Company)

A CEO who engages in private misconduct does not violate the Federal and state laws and regulations governing the workplace, but the misconduct can still jeopardize the company.

However, a CEO almost always has an employment agreement. The terms of the agreement will likely define firing “for cause,” which may affect severance benefits.

The directors must decide what is in the best interest of the company, even if they are close friends with the CEO. When is an executive’s non-work-related behavior a matter of sufficient concern to put a duty on the Board to investigate or take action?

THE END