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## TRUSTS-FIDUCIARY'S DUTY OF LOYALTY

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TRUSTS—FIDUCIARY'S DUTY OF LOYALTY—Defendant and testator were partners. Upon the death of the testator leaving a widow and children, defendant was named executor under the will with power to manage, control or sell any of the property in the estate. The testator's children's share vested in de-

defendant as trustee under the will. Thereafter, defendant formed a corporation to which he transferred the partnership property. Equal amounts of stock therein were issued to himself individually, and to himself in his fiduciary capacity for the widow and children; a number of shares were issued to a third party who had a contingent interest under the old partnership agreement. Subsequently, defendant purchased most of the outstanding shares of the third party for himself individually, thus securing a majority interest in the stock of the corporation and placing the widow and children in the position of minority shareholders. The widow and children sued to establish constructive trusts in one-half the stock acquired by the defendant from the third party. *Held*, defendant, in purchasing for his individual advantage, shares that were so connected with the trust property and the scope of his duties as fiduciary, through knowledge that came to him in his capacity as fiduciary, failed to measure up to the high standards of conduct required of a fiduciary. *Wootten v. Wootten*, (C.C.A. 10th, 1945) 151 F. (2d) 147.

"A person in a fiduciary relation to another is under a duty to act for the benefit of the other as to matters within the scope of the relation."<sup>1</sup> Trustees, executors and administrators, agents, attorneys, and partners, among others, all occupy fiduciary positions.<sup>2</sup> Each owes a duty of loyalty to the persons to whom he acts in a fiduciary capacity and if, in violation of his duty of loyalty to them, he seeks to acquire or retain for himself some property interest, he is chargeable as constructive trustee for them.<sup>3</sup> In defining this obligation on the part of the fiduciary, courts have held that it is improper for a fiduciary to sell the property of the beneficiary to himself individually;<sup>4</sup> to sell his individual property to himself as fiduciary where he has power to purchase property for the beneficiary,<sup>5</sup> or to purchase for himself individually property which it is his duty to purchase for the beneficiary.<sup>6</sup> Likewise, a constructive trust will be

<sup>1</sup> RESTITUTION RESTATEMENT 780, §§ 190-220 (1936); *Linsley v. Strang*, 149 Iowa 690, 126 N.W. 941 (1910).

<sup>2</sup> 16 WORDS AND PHRASES 515 (1940); *Clapp*, "Fiduciary's Duty of Loyalty," 3 MD. L. REV. 221 (1939).

<sup>3</sup> For an excellent treatment of this subject, see 2 SCOTT, TRUSTS, § 170 (1939); 3 SCOTT, TRUSTS, §§ 495-505 (1939).

The Maryland court suggests the following basis for the rule: "Remembering the weakness of humanity, its liability to be seduced, by self-interest, from the straight line of duty, the sages of the law inculcate and enjoin, a strict observance of the divine precept: 'Lead us not into temptation.'" *Hoffman Steam Coal Co. v. Cumberland C. & I. Co.*, 16 Md. 456 at 507 (1860).

<sup>4</sup> *Davoue v. Fanning*, 2 Johns. Ch. (N.Y.) 252 (1816); *Michoud v. Girod*, 4 How. (45 U.S.) 503 (1846); 77 A.L.R. 1513 (1932).

The rule is also applicable to the situation where the transfer is made to a corporation in which the trustee owns the majority of the stock. *Otier v. Neiman*, 96 Misc. 481, 160 N.Y.S. 610 (1916).

But, where the court was advised of the facts beforehand, and approved of the transaction, no constructive trust will arise. *Corbin v. Baker*, 167 N.Y. 128, 60 N.E. 332 (1901).

<sup>5</sup> *Cornet v. Cornet*, 269 Mo. 298, 190 S.W. 333 (1916). The rule applies equally where the property was owned by the trustee absolutely or where his interest in the property was such that it would affect his judgment in making the purchase. *Whitlow v. Patterson*, 195 Ark. 173, 112 S.W. (2d) 35 (1937).

<sup>6</sup> *Turner v. Fryberger*, 94 Minn. 433, 103 N.W. 217 (1905); *Johnston v. Loose*, 201 Mich. 259, 167 N.W. 1021 (1918).

imposed on property where the fiduciary, in violation of his duty to the beneficiary, acquires property by competing with the beneficiary<sup>7</sup> or acquires property through the use of confidential information acquired by him while in his capacity as a fiduciary.<sup>8</sup> While the usual rule is that undivided loyalty is the very essence of the relationship,<sup>9</sup> the testator may authorize the trustee to act in respect of securities in the estate without regard to whether or not the trustee has a personal interest in the same kind of securities, and thus deprive the estate of the benefit of the doctrine which forbids the trustee to act under circumstances involving divided loyalty.<sup>10</sup> However, in such a case, the trustee is still obligated to act honestly and in good faith.<sup>11</sup> Query: Where the trustee is, by the terms of the will, given power to act in respect to securities in which he is individually interested, and the trustee is himself a minority shareholder and holds an equal number of shares as trustee, does his fiduciary relationship prevent him from purchasing enough of the outstanding shares to give himself individually a majority of the shares, or must he purchase or offer to purchase one-half of said shares for his beneficiaries? In the few cases that have been decided on this point, the courts have split.<sup>12</sup> In a similar case,<sup>13</sup> where a testator owning 498 out of 500 shares in a company bequeathed 249 shares to the defendant individually and 249 to her as trustee, and she purchased from a third person the other 2 shares for herself individually, the court held that she was not guilty of a breach of trust although she thereby obtained a majority of the shares for herself individually. This view seems squarely opposed to that of the principal case, and the rule of the latter case is submitted as the more rational of the two, in view of the heavy emphasis placed by the courts on the duty of loyalty of a fiduciary. The imposition of a constructive trust where the trustee renews a lease in his own name when the original lease was to the trust,<sup>14</sup> and requiring the trustee to account for profits where he purchases for himself an outstanding incumbrance on the trust property<sup>15</sup> would seem by analogy to support the

<sup>7</sup> *Beatty v. Guggenheim Exploration Company*, 225 N.Y. 380, 122 N.E. 378 (1919); *Fox v. Simons*, 251 Ill. 316, 96 N.E. 233 (1911).

<sup>8</sup> *Essex Trust Company v. Enwright*, 214 Mass. 507, 102 N.E. 441 (1913); 47 L.R.A. (N.S.) 567, note (1914); *Hussong Dyeing Mach. Co. v. Morris*, (N.J. Ch. 1913) 89 A. 249.

Re trustee's duty to speak concerning any matter, of which he has knowledge, that would throw light upon the trust estate see, *In re Sedgwick's Will*, 74 Ohio App. 444, 59 N.E. (2d) 616 (1944).

<sup>9</sup> *Camden Trust Co. v. Cramer*, 136 N.J. Eq. 261, 40 A. (2d) 601 (1945).

<sup>10</sup> *In re Balfe's Will*, 245 App. Div. 22, 280 N.Y.S. 128 (1935).

<sup>11</sup> *Ibid.*; *WINTER, FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS* 86 (1938).

<sup>12</sup> 2 SCOTT, TRUSTS, § 170.23 (1939): "Where a trustee without fault on his part finds himself in a position where his individual interest conflicts with that of the beneficiaries, he must at least treat the beneficiaries as well as he treats himself."

But, *Anderson v. Bean*, 272 Mass. 432, 172 N.E. 647 (1930), held that where a trustee held one half the shares of a corporation as trustee and the other one half individually, it was not improper for him to sell some of the shares which he held as trustee, although the effect was that he could thereafter control the corporation by cooperating with any one of the purchasers.

<sup>13</sup> *In re Johnson's Estate*, 187 Wash. 552, 60 P. (2d) 271 (1936); 106 A.L.R. 220 (1937).

<sup>14</sup> *Keech v. Sandford*, Sel. Cas. T. King 61, 25 Eng. Rep. 223 (1726).

<sup>15</sup> *Merrick v. Waters*, 51 App. Div. 83, 64 N.Y.S. 542 (1900); *Earl v. Picken*, (App. D.C. 1940) 113 F. (2d) 150; 128 A.L.R. 917 (1940).

reasoning of the principal case. "The punctilio of an honor the most sensitive" should remain the standard of behavior for fiduciaries.<sup>16</sup>

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<sup>16</sup> Cardozo, C.J., in *Meinhard v. Salmon*, 249 N.Y. 458 at 464, 164 N.E. 545 (1928).