The Fiduciary Principle†

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A supposititious case which involves an example of crooked dealing by a fiduciary is to be found in the sixteenth chapter of the Gospel according to Saint Luke. Translated under the auspices of King James the First, it reads as follows:

There was a certain rich man, which had a steward; and the same was accused unto him that he had wasted his goods.
And he called him, and said unto him, How is it that I hear this of thee? give an account of thy stewardship; for thou mayest be no longer steward.
Then the steward said within himself, What shall I do? for my lord taketh away from me the stewardship: I cannot dig; to beg I am ashamed.
I am resolved what to do, that, when I am put out of the stewardship, they may receive me into their houses.
So he called every one of his lord's debtors unto him, and said unto the first, How much owest thou unto my lord?
And he said, An hundred measures of oil. And he said unto him, Take thy bill, and sit down quickly, and write fifty.
Then said he to another, And how much owest thou? And he said, An hundred measures of wheat. And he said unto him, Take thy bill, and write fourscore.
And the lord commended the unjust steward, because he had done wisely: for the children of this world are in their generation wiser than the children of light.¹

I am not here concerned with the theological aspects of this situation. I am interested simply as a lawyer in appraising the conduct of the steward. My interest is much like that of Mr. Weasel in Samuel

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Warren's immortal legalistic romance, Ten Thousand A-Year. Mr. Weasel was a barrister, a character wholly devoted, at all times and in all places, to the pursuit of the law. Of him the author says that "At church the reading of the parable of the Unjust Steward set his devout, ingenious and fertile mind at work for the remainder of the service, as to the modes of stating the case, nowadays, against the offender, and whether it would be more advisable to proceed civilly or criminally; and if the former, at law, or in equity."

The steward was certainly in a fiduciary position. He was entrusted with the management of his master's property. It was his duty in dealing with his master's affairs to act solely in the interest of his master. But what did he do? He made compromises with his master's debtors, relieving them of large parts of their debts. The account is not altogether clear, but it would seem that his purpose was to confer a favor upon the debtors with the hope that they would, after his discharge, confer favors upon him. It is possible, of course, that there was no hope of collecting more than a small part of the claims due to his master, and that in making the compromises he was trying to salvage something from a lot of impecunious debtors. If so, his conduct was perfectly proper. But, if so, the story would lose all point. It is evident that his purpose was to serve his own interests and not those of his master.

If this is so, the steward was certainly guilty of a clear breach of his fiduciary duty. If he were a trustee, a court of equity would remove him. The first duty of a trustee is, as stated in the Restatement of Trusts § 170, "to administer the trust solely in the interest of the beneficiary." It is this duty of loyalty, owing from every fiduciary to his principal, which I am to discuss in this paper. Professor Josiah Royce in his book on The Philosophy of Loyalty defined loyalty as "The willing and practical and thorough-going devotion of a person to a cause." And he says that "In loyalty, when loyalty is properly defined, is the fulfillment of the whole moral law."

The question arises at the outset, Who is a fiduciary? A fiduciary is a person who undertakes to act in the interest of another person. It is immaterial whether the undertaking is in the form of a contract. It is immaterial that the undertaking is gratuitous. Indeed, in England where the courts of equity have always been strict in the enforcement of fiduciary obligations of a trustee, a trustee is ordinarily

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2 Royce, The Philosophy of Loyalty (1930) p. 16.
3 Id. at 15.
entitled to no compensation for his services unless it is otherwise provided by the terms of the trust.

What are the usual fiduciary relations? They include the relation of trustee and beneficiary, guardian and ward, agent and principal, attorney and client, executor or administrator and legatees and next of kin of the decedent. The directors and officers of a corporation are in a fiduciary relation to the corporation, and to some extent at least to the shareholders. In a partnership each partner is in a fiduciary relation to the others, since, although he has his own interests to look after, he also has the power and the duty to look after the interests of the others. So too, as Mr. Justice Jackson pointed out in a case decided just before the close of the last term, a stockholder who brings suit on a cause of action derived from the corporation is a fiduciary, since he volunteers to sue, not for himself alone, but as representative of the corporation.4

Some fiduciary relationships are undoubtedly more intense than others. The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty. Thus, a trustee is under a stricter duty of loyalty than is an agent upon whom limited authority is conferred or a corporate director who can act only as a member of the board of directors or a promoter acting for investors in a new corporation. All of these, however, are fiduciaries and are subject to the fiduciary principle of loyalty, although not to the same extent.

Let us consider the basic nature and the extent of this duty of loyalty which a fiduciary owes to his principal.

A distinction must be made at the outset between the situations where he acts with the consent of his principal and the situations where he acts without such consent.

CONSENT OF THE PRINCIPAL

Where the fiduciary does an act which would be a breach of his duty as fiduciary if he did not have the consent of his principal, such consent will protect him only if he has in no way taken advantage of his position as fiduciary in procuring the consent. The relationship between the parties is very different from that between parties dealing with each other at arm's length. Thus in the Restatement of Trusts § 216, it is stated that the consent of a beneficiary of a trust does not preclude him from holding the trustee liable for a breach of

trust, if the beneficiary was under an incapacity, or did not know the facts and his legal rights, or if his consent was induced by improper conduct of the trustee, or if he was not of competent age and understanding. Moreover, where the trustee has an adverse interest in the transaction, the consent of the beneficiary will not preclude him from holding the trustee liable for a breach of trust if the transaction was not fair and reasonable. Thus if a trustee sells trust property to himself individually, the consent of the beneficiary to the sale will not prevent him from setting aside the sale, if he did not know all the facts and his legal rights, or if the trustee improperly induced him to consent or if the price and all other conditions of sale were not fair and reasonable. The consent of the beneficiary is indeed a slender reed upon which a trustee may lean.

Just as the consent given by the beneficiaries of a trust is not always a protection to a trustee, so the consent of the stockholders of a corporation is not always a protection to the corporate officers or directors. This was recognized by the Supreme Court of the United States in the case of Rogers v. Guaranty Trust Company, although the majority of the court held that the action should be dismissed because it had been brought in the wrong federal district. In that case the Board of Directors of the American Tobacco Company, of whom the president and officers constituted a majority of those present, passed a resolution by which the officers were given the right to subscribe for a large number of shares of the company at about a fourth of their market value, other shares being allotted in small amounts to employees. The stockholders in the previous year had approved an employees stock subscription plan, expressed in very general terms. Mr. Justice Stone, dissenting from the view of the majority that the suit could not be entertained because it was brought in the wrong district, said:

We need not conjecture whether, if the directors had had the hardihood to disclose in advance the benefits which they were to award to themselves, the stockholders would nevertheless have given their approval. Nor is it important that these directors have successfully managed the corporation and that under their direction it has earned large profits for its stockholders. Their business competence did not confer on them the privilege of making concealed or unauthorized profits or relieve them of the elementary obligation which the law imposes on all corporate directors to deal frankly and openly with

5 (1933) 288 U.S. 123.
stockholders in seeking their consent to benefit personally by reason of their relationship to the corporation.\(^6\)

**NO CONSENT OF THE PRINCIPAL**

So much for the case where the action of the fiduciary is with the consent of his principal. Now let us consider the cases where he acts without such consent. Under what circumstances is he chargeable with a breach of his duty?

*Self-dealing, sale of trust property.* Perhaps the simplest instance of breach of fiduciary duty is that which occurs where one is entrusted, whether as trustee or as agent (although not as a corporation director), with property to be sold by him, and he sells it to himself. No matter how fair the price may be, the sale is voidable. The principal can set it aside if the property goes up in value; he may affirm it if the property goes down in value. If there is a profit, the principal is entitled to it; if there is a loss, it falls upon the fiduciary. This is true not only where the fiduciary fixes the price of the sale, but also where the price is not fixed by him. The sale can be set aside even though the price is fixed by disinterested co-fiduciaries; it can be set aside even though the price is fixed by competitive bidding. There are numerous cases in which a fiduciary has purchased his principal’s property at a public auction, where he has outbid all others. In such a case one difficulty is that if the fiduciary himself is to bid, it is to his interest to dampen the sale, to discourage the attendance of prospective bidders, and to minimize prospective bids; whereas it is his duty to encourage the bidding. It is to his interest to have the property sold at a low figure; it is his duty to have it sold at as high a figure as is practicable. This is true even though the fiduciary himself has not brought about the sale, as in the case where the property is subject to a mortgage and the sale is brought about by the mortgagor or mortgagee.

It is immaterial whether the fiduciary purchases the property directly or indirectly. Where the purchase is made by a third person under an agreement with the fiduciary that he will resell the property to the fiduciary, the sale can be set aside. Such an agreement may be merely implied. The courts indeed have gone a step further. Even if there is no such agreement a sale by the fiduciary to his wife is no more valid than a sale to himself. Where, however, the sale is to a relative of the trustee, the sale is not necessarily invalid; its validity

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\(^6\) Id. at 143.
depends upon whether there is reason to believe that the fact that the purchaser was related to the fiduciary was an element in the transaction. Where he acts for his relative in the purchase of the property, the sale is clearly voidable. Thus in a case in Tennessee a real estate agent was employed by the owner of land to sell it for him. The agent purchased it as trustee for his mother, without disclosing this fact to his principal. He then resold the property at a profit which was received by his mother. It was held that he was personally liable to his principal for the amount of the profit. His filial duty to his mother did not justify his breach of fiduciary duty to his principal.

In a case in New York the owner of a parcel of land employed the defendants, real estate brokers, to find a buyer. They sold the property, at a price satisfactory to the owner, to a corporation of which one of the brokers was president and manager. They told the owner that they were selling the property to a client of theirs, but gave him no further information. It was held that the owner could recover from the brokers the amount of the commissions they received, and could recover from the corporation a profit which it made on a resale of the land. Judge Cardozo said:

As broker for the seller, the duty of this fiduciary was to make the terms as favorable to his employer and the price as high as possible. As president and manager of the buyer corporation, its sole representative in the transaction, his duty was just the opposite.

He further said that the conflict of interest was not sufficiently revealed when the brokers informed the seller that the sale was to be made to a client of theirs. The disclosure was too indefinite and equivocal. He said that “If dual interests are to be served, the disclosure to be effective must lay bare the truth, without ambiguity or reservation, in all its stark significance.”

Self-dealing, purchase of property for the trust. Just as a fiduciary violates his duty by selling to himself property entrusted to him for sale, so, conversely, he violates his duty when he sells his own property to himself as fiduciary. Thus if a trustee or agent is entrusted with money which it is his duty to invest, and he invests it by purchasing property from himself individually, he violates his duty. The purchase is voidable by the principal, whether or not the price

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8 Wendt v. Fischer (1928) 243 N. Y. 439, 154 N. E. 303.
9 Id. at 443, 154 N. E. at 304.
10 Ibid.
paid was a fair price. If the fiduciary made a profit through the sale, he is accountable for the profit. If a loss results to the principal, he must make good the loss. There is a breach of fiduciary duty even though the property sold was not owned entirely by the fiduciary; it is enough that he has an interest in the property of such a substantial nature that it might affect his judgment in making the purchase. The principle has been applied where the property is purchased from a partnership of which the fiduciary is a member, or from a corporation of which he is a principal officer or shareholder.

The principle is applicable to corporate fiduciaries. Thus a trust company is guilty of a breach of fiduciary duty where it purchases for a trust administered by it property owned by it in its individual capacity. In the case of national banks, which since 1913 have been permitted to act in fiduciary capacities, the duty of loyalty is laid down in a Regulation promulgated by the Federal Reserve Board. This provides that "Funds received or held by a national bank as fiduciary shall not be invested in stock or obligations of, or property acquired from, the bank or its directors, officers, or employees, or their interests, or in stock or obligations of, or property acquired from affiliates of the bank."11 There is also a provision as to the converse situation to the effect that trust assets shall not be sold or transferred to the national bank, to its directors, officers, or employees, or their interests, or to affiliates of the bank.12

Other violations of the duty of loyalty. In the situations which I have been considering, the fiduciary is guilty of that particular kind of breach of the duty of loyalty known as self-dealing. The fiduciary as such deals with himself as an individual. He is on both sides of the transaction. But there may be a violation of the duty of loyalty where the trustee is not guilty of self-dealing. He may violate his duty where he is dealing with a third person.

Bribes and commissions. The simplest case is where the fiduciary receives a bribe from a third person with whom he is dealing in his principal's affairs. The common situations of this sort involve agents, or trustees, or corporate officers or directors. A case which is a little out of the ordinary run arose in England last year.13 A British army sergeant received bribes amounting to £20,000 for escorting while in uniform a lorry through Cairo so that it could pass the civilian po-

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11 20 CODE FED. REGS. § 206.11(a) (1948).
12 20 CODE FED. REGS. § 206.11(b) (1948).
lice without inspection. The military authorities took possession of the money. The sergeant brought a petition of right against the Crown to recover it, and he even demanded interest thereon. It was held that his petition should be dismissed. Although the sergeant was not acting in the course of his employment in receiving the bribes, he got them by using the uniform of the Crown, and the Crown was entitled to the money. Mr. Justice Denning said:

There are many cases in the books where a master has been held entitled to the unauthorized gains of his servant or agent. At law, the action took the form of money had and received. In equity there was said to be a constructive trust due to a fiduciary relationship. Nowadays it is unnecessary to draw a distinction between law and equity. . . . The claim here is for restitution of moneys which in justice, ought to be paid over. It matters not that the master has not lost any profit, nor suffered any damage. Nor does it matter that the master could not have done the act himself. It is a case where the servant has unjustly enriched himself by virtue of his service without his master's sanction. It is money which the servant ought not to be allowed to keep, and the law says it shall be taken from him and given to his master, because he got it solely by reason of the position which he occupied as a servant of his master.14

The conduct of the fiduciary may involve a violation of his duty of loyalty where he receives some benefit for himself, even though it does not concern something so crass as a bribe. This is the case, for example, where he receives a commission in connection with what is otherwise a perfectly proper business transaction entered into by him on behalf of his principal. Thus a fiduciary has been held accountable for commissions which he received as a real estate broker or a stock broker or a fire insurance agent, in buying or selling or insuring property of the trust. It is immaterial that the same commission would have been payable to a third person acting as such broker or agent.

Let us return to the case of the Unjust Steward. He received no bribe or commission from his master's debtors. All that he got in return for the partial release of his master's claims against them was the hope that, as he had conferred a financial benefit upon them, they would after his discharge from his stewardship confer benefits upon him. Since he thus acted in his own interest and not in that of his master, he betrayed the confidence which had been placed in him. He may not have been subject to indictment for a criminal offense, but he was certainly civilly liable for the loss which he caused to his mas-

14 *Id.* at 275.
ter; or at least this would be so in the United States of America today. If the master chose not to insist upon his right, that was his privilege.

**Purchase of encumbrances on the trust property.** Another typical situation in which a fiduciary is not permitted to retain a profit made by him through dealings connected with the property entrusted to him, is that in which he purchases at a discount an encumbrance upon the property. In such a case he is accountable for any profit which he realizes thereby, even though the profit is not made at the expense of his principal. A trustee, for example, purchases a mortgage upon the trust property, paying the mortgagee ninety cents on the dollar. When the mortgage matures, the property is sufficient to pay the mortgage in full. Nevertheless the trustee is entitled only to the amount which he paid for the mortgage with interest, and not to the profit which the mortgagee himself would have been entitled to if he had retained the mortgage.

It is true that ordinarily an officer or director of a corporation who purchases at a discount a bond of the corporation and sells it at a profit or realizes its face amount on its maturity is not accountable to the corporation for the profit. The doctrine as to the purchase of an encumbrance by a fiduciary upon the property entrusted to him is not carried to its extreme possible limits. It is held, however, that where the corporation is bankrupt, a director who purchases claims against it at a discount will not be permitted to profit thereby and can enforce them against the corporation only at their cost to him. In a case decided by the Court of Appeals for the Third Circuit, the chairman of a committee of holders of shares of preferred stock of a corporation which was being reorganized under the Bankruptcy Act was a member of a firm which as dealer purchased and sold some of these shares. It was held that this was a breach of fiduciary duty, and that he was not entitled to compensation for his services or reimbursement for his expenses.

In these, as in so many situations, there are border-line cases where the experts disagree. A case of this sort was recently decided by the Court of Appeals for the Second Circuit. In that case a corporation which operated an apartment house had outstanding debentures of the face value of about $250,000. When the corporation was in financial distress, although no bankruptcy proceeding was pending or contemplated, an officer and director purchased for his wife and

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10 *In re* Calton Crescent (C. C. A. 2d 1949) 173 F. (2d) 944.
mother some of the debentures, paying about $8,000 for debentures of the face value of about $100,000. Acting on a tip from the director, a friend of his also purchased debentures. Thereafter bankruptcy proceedings were brought and the property was sold at a price sufficient to pay the debenture holders over 43 cents on the dollar. It did not appear that there was any failure to disclose facts to the sellers of the debentures, and they made no claim. The question was whether the director's wife and mother and friend should be allowed to prove their claims for the full amount, receiving the dividend thereon of 43 cents although they paid only 8 cents on the dollar, thus making a profit from the purchase, or whether they should be permitted to recover only the price they paid with interest. The court was divided. Judge Swan permitted them to recover the profit, suggesting that even if the director himself had made a profit, under the circumstances he would be entitled to it, and holding that at any rate the three claimants were so entitled. Judge Chase concurred. Judge Learned Hand dissented, believing that the strict rule as to the purchase of encumbrances by a fiduciary should be applied.

Renewal of leases. Where a person holds a lease in a fiduciary capacity and obtains a renewal of the lease for himself individually, he is guilty of an abuse of fiduciary duty and is chargeable as a constructive trustee of the new lease. This principle has frequently been applied to trustees, to partners and to other fiduciaries. In a case in Massachusetts a partnership was engaged in business on premises leased by it. Shortly before the lease expired one of the partners, the plaintiff, without the knowledge of another partner, the defendant, unsuccessfully attempted to obtain a new lease in his own name from the owner of the premises. The defendant was successful in doing that very thing; he obtained a new lease for himself. It was held that the defendant must hold the lease for the partnership. The court said that "for the defendant to take the option in his own name and attempt to appropriate the profits thereof to his own use constituted not only a breach of trust but a fraud upon his copartners." The plaintiff was not barred merely because he had attempted without success to do just what the defendant did.

A close case, in which the court was divided, four judges taking one view and three the other, is that of Meinhard v. Salmon, de-

18 Id. at 231, 102 N. E. at 634.
19 (1928) 249 N. Y. 458, 164 N. E. 545.
cided by the New York Court of Appeals a few years ago. In this famous case the plaintiff and defendant as joint adventurers held a lease of a hotel at the corner of 42nd Street and Fifth Avenue in the city of New York. The lease was for twenty years and was taken in the name of the defendant, who was to have the active management of the undertaking. Shortly before the lease expired, the defendant, without communicating with the plaintiff, obtained a new lease which included not only the tract which was the subject of the joint undertaking but also large adjoining tracts owned by the lessor. The new lease was for a much longer term and at a much higher rental than that of the old lease. ($350,000 instead of $55,000) The old buildings were to be torn down and a new building to be erected at a cost of three million dollars. The defendant formed a corporation to hold the new lease. The plaintiff brought suit to compel the defendant to give him an equal share in the new lease. The Court of Appeals held that the plaintiff was entitled to one-half of the shares of the corporation, less one share. Chief Judge Cardozo, speaking for the majority, said that the parties were in a fiduciary relation to each other and that the defendant was chargeable as a constructive trustee, since he had a "pre-emptive opportunity," which was an incident of the joint undertaking and which he should not have used for his own benefit alone. The case is not as easy as the usual case of a renewal of a lease. In the first place the fiduciary relation was a temporary one, due to expire when the old lease expired; and the new undertaking was a much larger undertaking than that which had been involved in the joint adventure. Nevertheless, the decision of the court has met with general approval.

Competition with the principal. Delicate questions arise where the fiduciary acquires a benefit for himself in conducting a transaction of his own, but where he does so to some extent in competition with his principal. The question here is one of degree. It is a question of the closeness of the connection between what he does for himself and what he has undertaken to do for his principal. In 20 Beatty v. Guggenheim Exploration Company, another case in New York, the plaintiff was employed by the defendant, an exploration and mining corporation. It sent him to Alaska to investigate certain mining claims on which the defendant had an option. He discovered that there were certain adjoining claims not included in the option but which appeared to be necessary for the successful operation of those which were in-

cluded. He bought these claims for himself and a partner. The court held that if the corporation had not waived its rights, the plaintiff would have been bound to surrender the claims at cost. Judge Cardozo said: "We think it would be against good conscience for the plaintiff to retain these profits unless his employer has consented. The tie was close between the employer's business and the forbidden venture." 21

In an English case 22 a testator carried on the business of a yacht agent. By his will he appointed his daughter and the defendant and another person as executors and trustees and directed them to carry on his business. The defendant was about to set up a business of a yacht agent on his own account in competition with the testator's business, while still remaining a trustee of the will. The court held that this would be a breach of his fiduciary duty, pointing out that this particular kind of business was highly competitive, since the field was a limited one. So also in a case in New York 23 an executor continued the testator's business of making installment sales, as he was authorized to do by the will. He started a competing business on his own account. It was held that he was accountable for the profit which he made, and he was enjoined from continuing the competing business even after he had been removed as trustee.

There is another situation where a fiduciary improperly competes with his principal. Where a fiduciary purchases property which he should purchase for his principal, if he purchases it at all, he is chargeable as a constructive trustee of the property so purchased. It frequently happens that a man who wishes to acquire the title to property, but does not wish to appear himself in the transaction, engages another person to purchase the property for him; and all too frequently the latter, discovering that it is a good bargain, purchases the property for himself. It is clear enough that he will not be permitted to retain the property where there was a pre-existing fiduciary relationship between the parties, as, for example, where the person who purchases the property was an employee of the other, or where the intending purchaser was a corporation and the person making the purchase was an officer or director. The case is not so clear where there was no such pre-existing fiduciary relationship. If $A$ asks $B$ to purchase a piece of land for $A$, and $B$ undertakes to do so, and $B$

21 Id. at 386, 122 N.E. 380.
22 In re Thomson (1930) 1 Ch. 203.
23 In re Offen's Estate (1943) 45 N.Y.S. (2d) 348.
purchases it for himself, there are difficulties in the path of \( A \) when he seeks to charge \( B \) as constructive trustee of the land for him. Unless there was consideration for \( B \)'s undertaking there is no binding contract, and, indeed, in most jurisdictions, the contract would be unenforceable if not in writing. There need not be a contract, however, to give rise to a fiduciary relation. By the very fact that \( B \) undertakes to act for \( A \) he becomes \( A \)'s agent for this purpose. If, therefore, he buys the property for himself he is guilty of a breach of fiduciary duty. Whether he could have terminated the agency by informing \( A \) that he wished to do so and that he intended to purchase the property for himself is another question. Even in such a case, he would be chargeable with a breach of duty if he took advantage of confidential information given to him by \( A \) as his agent.

**Competition by corporate officers and directors.** Corporate officers and directors frequently find themselves in a position where they are tempted to secure for themselves some advantage which if it is to be secured at all, should be secured for the corporation. Thus in a case in New York\(^{24}\) the directors of a corporation cancelled a contract which gave it the exclusive right to sell a foreign firm’s product, and then made a similar contract for themselves with the firm. The court held that they were not merely liable for the loss to the corporation which resulted from the cancellation of the contract, but were accountable in equity for any profits which they made from their own contract.

Sometimes the breach of fiduciary duty is not so bold. It is not a ground for denying relief to the corporation that it did not have a pre-existing interest in the property acquired by the officer or director. Nor will relief be denied merely because it does not appear that the corporation was financially able to purchase the property for itself. Nor need it appear that the purchase was necessary to the furtherance of the corporate undertaking. It is enough that the officer or director has improperly interfered with an expectancy of the corporation, with what is called a corporate opportunity. The rule rests on the unfairness in the particular circumstances of the taking advantage of an opportunity for personal profit when the interests of the corporation call for protection.\(^{25}\)


\(^{25}\)Compare Durfee v. Durfee & Canning, Inc. (1948) 323 Mass. 187, 80 N.E. (2d) 522, where a director was held liable, with Blaustein v. Pan American Petroleum & Transport Co. (1944) 293 N.Y. 281, 56 N.E. (2d) 705 where recovery by a subsidiary corporation against the controlling corporation was denied.
Corporate fiduciaries. Corporate fiduciaries are sometimes faced with problems of loyalty which do not arise in the case of individual fiduciaries. Banks and trust companies acting as trustees are subject, as we have seen, to the rules of loyalty which are applicable to individual trustees. There are, however, two situations where a question of loyalty arises because they are corporate fiduciaries.

Shares of a corporate trustee. The first situation involves the question of the holding of shares of its own stock by a corporate trustee. It is well settled that a corporate trustee cannot properly purchase for its trust shares of its own stock, even though the purchase is made from a third person. Such a purchase is expressly forbidden in the case of national banks by a Regulation of the Federal Reserve Board, and is forbidden by statute in several states. A more difficult question arises where a testator owned shares of a bank or trust company and died naming the institution as trustee. Is it the duty of the trustee to dispose of the shares within a reasonable time, or may it properly retain them in the trust? It has been held that in the absence of a term of the trust or of a statute otherwise providing, the trustee should not retain the shares in the trust. It is true that the retention does not involve self-dealing. It does, however, involve a conflict of interest, a divided loyalty. The testator may, however, and frequently does, authorize the corporate trustee to retain the shares, and such an authorization is clearly valid. It seems clear that a general authorization to retain the testator's investments includes his investments in shares of the corporate trustee.

Self deposit by a corporate trustee. In the second place, there is a question whether a bank or trust company, acting as trustee, can properly deposit funds awaiting investment or distribution in its own commercial or savings department. In the absence of a statute otherwise providing, there is a conflict on the question whether such deposits constitute improper self-dealing. In the case of national banks it is provided by the Federal Reserve Act and by Regulations of the Federal Reserve Board that such deposits are proper if securities are deposited with the trust department as collateral to secure such deposits. In a number of states there are similar statutes applicable to the state banks and trust companies. Although in such a case there is no substantial risk of loss of the trust funds so deposited, there is a temptation to the trustee to leave the funds on deposit for an unreasonably long time, since the deposits are ordinarily earning an income for the bank or trust company.
Confidential information. A fiduciary in the course of his employment may acquire confidential information. It is a breach of his duty as fiduciary to use this information for his own purposes, or to communicate it to a third person who may so use it. This principle is expressed in the Restatement of Agency § 295. It is there stated that "Unless otherwise agreed an agent is under a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge."

The principle applies to trade secrets, lists of customers, and other confidential matters known to the employee because of his employment. It applies not only to agents but to other kinds of fiduciaries, such as trustees and corporate officers and directors. It applies, for example, to attorneys. Thus, in a case recently decided in New York, a rather unusual one, a question of the extent of the duty of loyalty of an attorney was involved. In that case the defendant was employed as attorney by the next of kin of a testatrix to contest her will for lack of testamentary capacity. In this he was unsuccessful. By the will a legacy was given for a charitable purpose which failed. The defendant disclosed information which he had obtained as attorney for the next of kin to a charitable corporation, which thereupon employed him to apply to the court for an application of the legacy _cy pres_ in its favor. He was successful in this application. It was held that he was chargeable as constructive trustee for the next of kin of the compensation which he received from the charitable corporation. The court held that the defendant should not be allowed to profit through a breach of his fiduciary duty to the next of kin, even though the next of kin had no enforceable claim to the estate.

The principle has been applied even where the information was acquired by the fiduciary more or less accidentally and not in connection with the performance of his duties. In a case in Massachusetts, a newspaper reporter, employed on part time, learned that his employer had only a leasehold interest in the premises upon which the paper was published, and that the lease was about to expire. He

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20 Zeiden v. Oliphant (1945) 54 N.Y.S. (2d) 27.
27 Essex Trust Co. v. Enwright (1913) 214 Mass. 507, 102 N.E. 541.
went to the owner of the property and obtained a lease in his own name and offered to convey the lease to his employer for a sum much larger than he had paid for it. If the employer could not obtain the lease it would mean a serious interruption in the publication of the paper. It was held that the employer could charge him as constructive trustee of the lease and compel him to surrender it at the price which he had paid.

**Liabilities of third persons.** Not only does a fiduciary incur liabilities if he violates his duty to his principal, but third persons who participate in the breach of duty may also incur liabilities. The simplest case, perhaps, is that in which a trustee in violation of his duty sells trust property to a third person. The third person takes the property subject to the trust, unless he is a purchaser for value and without notice of the breach of trust. So also, there are numerous cases where a third person has obtained knowledge of a trade secret through a breach of duty by a fiduciary who had been entrusted with the secret, and has used it for his profit. He is held accountable for the profit.

Third persons other than purchasers of trust property or trade secrets may be chargeable as participants in breaches of fiduciary duty: for example depositaries of trust funds, brokers, corporations registering improper transfers by fiduciaries of shares of stock, agents and attorneys. Such persons are chargeable with participation in a breach of fiduciary duty where with notice of the breach they assist the fiduciary in violating his duty. Mr. Justice Stone pointed out that departures from the fiduciary principle do not usually occur without the active assistance of some member of the bar, and that during the period preceding the debacle of 1929 the bar was too absorbed in taking care of private interests to sound a warning against the prevailing disregard of the fiduciary principle.28

To return again to the case of the Unjust Steward, the question suggests itself whether the master could have set aside the compromises and compelled the debtors to pay the balance of his claims against them. I am no expert in the Hebrew law and can deal with the question only from the point of view of an American lawyer. Certainly if the debtors knew that the steward was attempting to feather his own nest by currying favor with them and therefore that he was violating his duty to his master, they would be liable for the unpaid balances. Even if they did not know this, they gave no value for the discharge, and under our law they might still be liable. But apparently

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the good-natured master waived his claims against them, as well as that against the steward.

CONCLUSION

Let me conclude by quoting from the two great judges to whom I have referred from time to time; two judges who I think were most clearly conscious of the vital importance of the fiduciary principle.

Fifteen years ago, Mr. Justice (later Chief Justice) Stone, in a notable address on The Public Influence of the Bar said:

I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that 'a man cannot serve two masters.' More than a century ago equity gave a hospitable reception to that principle and the common law was not slow to follow in giving it recognition. No thinking man can believe that an economy built upon a business foundation can permanently endure without some loyalty to that principle.

In the famous case of Meinhard v. Salmon, to which I have already referred, Chief Justice Cardozo (later Mr. Justice Cardozo) said:

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

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29 Id. at 8.

30 Meinhard v. Salmon, supra note 19 at 464, 164 N.E. at 546. That such “uncompromising rigidity” with respect to trustees may not be followed in case of directors of corporations see Ballantine, CORPORATIONS (1946) 157, 203, 209; Note (1948) 61 Harv. L. Rev. 335. These writers suggest that in regard to the fiduciary duty of a director the policy of facilitating business has prevailed over the older policy of removal of temptation.