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Wood Prince v. Lynch: Opening the Door for Subsequent Misapplications of the Business Judgment Rule to Claims Alleging that a Trustee has Breached His Fiduciary Duty of Loyalty

In *Wood Prince v. Lynch*, the Rhode Island Superior Court considered the issue of whether the fiduciary duties of directors are the same as the duties owed by trustees in the situation where the directors of a trust corporation also serve as its trustees. In reaching its unsupported conclusion that the fiduciary duties of trustees and directors are substantially similar, the court overlooked important case law holding that trustees owe a higher fiduciary duty of loyalty than directors. The court’s failure to distinguish that trustees and directors owe different degrees of loyalty results in the court incorrectly applying the more lenient business judgment rule rather than the more strict form of scrutiny that trust law principles demand. In effect, the court’s holding serves to chip away at the significant distinctions between the fiduciary duties of trustees and directors and opens the door for subsequent courts to similarly misapply the business judgment rule to transactions involving allegations of trustee breaches of the fiduciary duty of loyalty.

I. THE CASE

Frederick H. Prince IV and William Norman Wood Prince, the trustees of the Frederick Henry Prince Deed of Trust ("Trust") and the acting directors of CMD Realty Investor's, Inc., brought this action before the Rhode Island Superior Court seeking judicial approval of the reorganization of CMD Realty Investors, L.P., the management company of CMD Realty Investor's, Inc. CMD Realty Investor's, L.P.

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4. *Wood Prince*, 2005 WL 373805, at *1. CMD Properties, Inc. owns a real estate portfolio having a value of approximately $300,000,000, and constitutes in value approximately 80% of the Trust’s assets. *Id.*
5. *Id.* The stock of a corporate entity, F.H. Prince and Co., Inc., is a principal asset of the Trust. The Trust has owned this stock since the inception of the Trust. The primary asset of Prince, in turn, is all of the stock interest of CMD Corp. CMD Corp. has a number of subsidiaries, one of which is CMD Realty Investor’s, Inc. *Id.*
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(“management company”) was created in 1997 as a response to the expanded business practices of CMD Realty Investor’s, Inc. The business practices of CMD Realty Investor’s, Inc. began growing under the guidance of a non-trustee and non-beneficiary President as well as a senior management team, and eventually expanded into the commingled fund business with outside institutional investors in 1985. The management company was created by an agreement of limited partnership in which CMD Realty Investor’s, Inc. “was the sole general partner with a 50% interest and a general partnership known as CMD Management Partners, consisting of the members of senior management, was the sole limited partner holding the other 50% interest.” Since 1997, the management company has managed all of the CMD properties as well as the commingled investment fund portfolios.

The argument before the court derives from the contemplated natural termination of the trust in the year 2019, and the impact that disharmony between the trustees and the beneficiaries might have on potential investors in the future commingled real estate investment funds that the management company and the trustees wish to establish. The trustees argue that because a trust related entity is the general partner of the management company and because of the instability resulting from the conflict with certain beneficiaries, the trustees and the management company have an obligation to disclose issues relating to the fact that the trust related entity is the general partner of the management company to any potential

6. Id. at *2.
7. Id. at *1. The CMD management company also directs several funds primarily invested in real property: CMD Investment Fund, LP (a $100,000,000 limited partnership created in 1993); CMD Investment Fund II, LP (a $125,000,000 limited partnership created in 1995); CMD Investment Fund III, LP (a $208,000,000 limited partnership created in 1997); and CMD Realty Investors IV, LP (a $287,700,000 limited partnership created in 1998). Prince related entities invested $20,000,000, $10,000,000, $18,000,000, and $15,600,000, respectively, in the four above mentioned funds for a total investment in excess of $63,000,000. Id.
8. Id. at *2.
9. Id. In connection with entering into the commingled fund investment business, awarding profit sharing to senior management, and creating the management company, no prior court approval was sought or obtained. Additionally, “the evidence before the court show[ed] that from the time of the 50% profit sharing arrangement with senior management [in 1997], approximately $70,000,000 in profits from the real estate management business have been split with the Trust.” Id. Specifically, under the new structure,

[i]the trust owned entity will have (i) veto rights only with respect to certain major decisions; (ii) a continued right to 50% of the profits from any new investment fund while the status quo will be maintained as to the existing funds and the Trust’s own real estate portfolio; (iii) a right to terminate the Management Contract of the reorganized entity as to the Trust’s wholly owned real estate portfolio (a) for cause (including failure to perform to industry standards) and (b) without any cause at any time after the exercise by the Trust owned entity CMD, Inc. of the ‘put’ referred to in the next numbered provision; (iv) at any time the right to put its interest in the reorganized Management Company to its 50% partner, the senior management group, which has a corresponding obligation to buy that interest for a price to paid over time which is to be one-half the entity value as determined at the time of the exercise of the put.

Id. at *3.
10. Id. at *2. The Trustees disclosed that the estimated going forward value of the management company is between $40,000,000 and $50,000,000. Id.
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investor in a new commingled investment fund. The trustees argue that the proposed reorganization of the management company will obviate the need for disclosure because the reorganized management company, while still fifty percent owned by a trust wholly owned entity, will be structured so that day-to-day management will be controlled by senior management, and thus not subject to the conflicts between the trustees and the beneficiaries. The trustees urge the court to approve the contemplated reorganization as a proper exercise by them of their discretion as trustees and as a proper exercise by them of their business judgment.

Four of the living beneficiaries of the trust are opposed to the reorganization, and contend that the trustees have violated their fiduciary duties as trustees. The beneficiaries further allege that the trustees have a conflict of interest in the reorganization of the management company, and thus their duty of loyalty is called into question. In support of this claim, the beneficiaries point out that one of the effects of the proposed management restructuring would be to preclude employment opportunities for certain beneficiaries within the company. The beneficiaries argue that by removing the opportunity for certain male beneficiaries to be employed by the management company, the trustees' own expectations with respect to the principal distribution at the termination of the trust are enhanced. The beneficiaries also point out that restructuring the management of CMD Realty Investors, L.P. (the managing company) primarily benefits the senior management team rather than the trust (and will result in a twenty percent loss of profit for the trust) as further proof in support of their allegation that the trustees have breached their duty of loyalty.

The court, applying the business judgment rule, held that the trustees were acting in accordance with their fiduciary duties and that they could therefore continue to negotiate, execute, and consummate the reorganization of the management company.

II. LEGAL BACKGROUND

Directors of corporations owe to their shareholders the fiduciary duties of good faith, due care, and loyalty. Claims brought by shareholders alleging that a direc-

11. Id. at *2–3.
12. Id. at *3.
13. Id.
14. Id.
15. Id.
16. Id. Article II, section 3 of the Trust provides: "Upon the termination of the trust period, the trustees shall pay over... fifty percent (50%) of the capital of the trust estate (a) to and among the male children and/or more remote male issue of myself and of my cousin, Bernard Henry-Wood, Jr. who are then serving F.H. Prince & Co. Inc. as directors, officers, or employees. . ." Id. at *3 n.3.
17. Id. at *3.
18. Id. at *7.
19. Id. at *8.
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tor has breached his duty of either good faith or due care are usually analyzed using the business judgment rule. When a claim is brought against a corporate director alleging that he has violated his duty of loyalty, it may also be analyzed using the business judgment rule, provided that certain requirements are met. The business judgment rule is a deferential standard of review that serves, in most cases, to protect a director's valid exercise of his business judgment in arriving at a business decision.

Trustees owe the fiduciary duties of due care, good faith, and loyalty to the beneficiaries of a trust. Although the fiduciary duties of directors and trustees are the same in kind, they are not the same in degree. In particular, trustees owe a higher fiduciary duty of loyalty than do directors and, thus, the correlating standard of review is one of more heightened scrutiny than that provided by the business judgment rule. Theoretically, this heightened standard of review should serve to be more protective of the interests of the party bringing suit (the beneficiary of the trust) than would the business judgment rule.

A. The business judgment rule in general

The business judgment rule is a common-law standard of judicial review designed to protect the wide latitude conferred on a board of directors in handling the affairs of the corporate enterprise. The rule, as it exists under Delaware law and in other jurisdictions, is based upon the rationale that directors are better equipped than courts to make business judgments. The business judgment rule is therefore a deferential standard that establishes a rebuttable presumption that, in making their business decision, directors acted in good faith and without self-dealing or personal interest.

22. These requirements are those enumerated by Del. Code Ann. tit. 8, § 144 (2001), which provide that the business judgment rule may apply when a majority of disinterested board members approve a transaction, or when a majority of shareholders approve a transaction.
26. Stegemeier, 728 A.2d at 563. Where the claim alleges a breach of a trustee’s fiduciary duty of loyalty (which encompasses conflict of interest and self-dealing), a court should distinguish between the fiduciary duties of trustees and directors in order to properly hold trustees accountable for their actions at law. Id.
One of the most widely quoted formulations of the business judgment rule is the Delaware Supreme Court's articulation in *Aronson v. Lewis*.

In *Aronson*, the court stated that the rule

is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company . . . . The burden is on the party challenging the decision to establish facts rebutting the presumption.

Under the business judgment rule, the business decision made by the directors will be upheld unless the party challenging the decision can show one of four elements: (1) the directors did not make a decision; (2) the directors' decision was uninformed; (3) the directors were not disinterested or independent; or (4) the directors were grossly negligent or wasteful in their decision.

**B. Even when directors are found to be acting in their own self-interest, exceptions exist that may still allow the business judgment rule to apply**

It should be noted that the business judgment rule does not automatically apply to claims that allege that directors have breached their duty of loyalty. The business judgment rule serves as a presumption that a board has acted loyally, but this presumption may be rebutted by a plaintiff who is able to show that a majority of the directors have a financial interest in the transaction. If the party challenging the directors' decision can demonstrate that a director was interested, then the standard may shift from the business judgment rule to the more demanding “entire fairness” or intrinsic fairness test. However, if a single director, or a minority of directors, has a conflicting interest, the decision of the board as a whole may still be entitled to the protection of the business judgment rule if the material facts relating to the conflict of interest are disclosed to the board, and the board in good faith authorizes the transaction by a majority vote of the disinterested directors. In *Orman v. Cullman*, the Delaware Chancery Court specifically noted that “[i]f a plaintiff alleging a duty of loyalty breach is unable to plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence, the entire fairness standard of review is not applied and

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31. *Id.* (citations omitted).
33. *Treadway Cos., Inc. v. Care Corp.*, 638 F.2d 357, 384 (2d Cir. 1980).
34. *Aronson*, 473 A.2d at 812.
35. *Id.*
38. 794 A.2d 5 (Del. Ch. 2002).
the Court respects the business judgment of the board.” Thus, a claim alleging that a director has breached his duty of loyalty may still reach adjudication utilizing the business judgment rule.

For example, the business decision of an interested director may be evaluated under the business judgment rule if either a majority of disinterested directors approve the decision, or if a majority of shareholders approve the decision. At common law, a corporation’s stockholders had the power to nullify an interested transaction, although “considerations of the transaction’s fairness played some part in judicial decisions applying this rule.” In Delaware, however:

The enactment of 8 Del. C. §144 in 1967 limited the stockholders’ [common law] power in two ways. First, section 144 allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule. Second, where an independent committee is not available, the stockholders may either ratify the transaction or challenge its [entire] fairness in a judicial forum.

In the situation in which shareholders choose not to ratify the transaction, but instead challenge its fairness in court, the directors carry the burden of establishing the transaction’s entire fairness. If a transaction is found to be unfair to the corporation, the stockholders may then demand rescission of the transaction; but if “the directors meet their burden of proving entire fairness, the transaction is protected from stockholder challenge.” As long as a given transaction is fair to the corporation, it does not matter that some corporate directors will profit as a result of the transaction.

Another way a claim alleging that a corporate director has violated his duty of loyalty may be evaluated under the business judgment rule is if the party bringing suit against the director cannot meet the corporate law requirements of self-interest. Specifically, in order for a director to be found interested, he must typically appear on both sides of the transaction. For example, in Sinclair Oil Corp. v. Levien, the Delaware Supreme Court held that, although the shareholders alleged that the directors had breached their fiduciary duty of loyalty, the burden of proof

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39. Id. at 23.
40. DEL CODE ANN. tit. 8, § 144 (2001).
43. Weinberger v. UOP, 457 A.2d 701, 710 (Del. 1983).
44. Oberly, 592 A.2d at 466.
45. Id. at 467.
46. Id. at 466. The definition of self-interest in the corporate world is more exacting than it is in most other bodies of jurisprudence. Id.
47. Id.
48. 280 A.2d 717 (Del, 1971).
shifted to the parent company to prove intrinsic fairness in dealing with its subsidiary only when the violation of fiduciary duty is accompanied by self-dealing. Therefore, in order to get out from under the business judgment rule, a party seeking to challenge a decision made by directors on grounds of self-dealing must be able to show that the directors were on both sides of the transaction. If a party can meet this requirement, he may then have the transaction examined under the entire fairness test.

C. Trustees owe a higher fiduciary duty of loyalty; claims alleging that a trustee has breached his duty of loyalty are evaluated using a heightened standard that is akin to corporate law’s "entire fairness" test

A trustee is a fiduciary “of the highest order in whom the hope and confidence of the settlor are placed with the expectation that the trustee will exercise the obligations of the office for the exclusive benefit of those holding beneficial interests.” As a fiduciary of the highest order, a trustee is “inescapably burdened with the positive responsibility of exercising prudence in trust administration and may be subject to an even higher measure of sagacity in pursuance of the integrity [and loyalty] required by the trust relationship” than the prudence with which corporate directors are charged with in meeting their fiduciary obligations. Indeed, corporate directors have somewhat more leeway with which to act than do trustees, for “[a]cts which might well be considered breaches of trust as to other fiduciaries have not always been regarded in cases of corporate officers or directors.” The character and consequences of the acts of a corporate director are determined on the basis of the facts of each case. On the other hand, the actions of trustees are subject to stricter conformation with their duty of loyalty.

Claims brought by beneficiaries alleging that a trustee has breached his fiduciary duty of loyalty are examined under a closer form of scrutiny than that provided by the business judgment rule. Under this standard, the trustees have the burden of

49. Id. at 720. The Delaware Supreme Court stated that: “[a] parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. This alone, however, will not evoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing, meaning the situation when a parent is on both sides of a transaction with its subsidiary.” Id.
50. Id.
51. Id. at 721–22.
53. Id. at 1144–45. The Oklahoma Supreme Court applied principles of trust law to the self-dealing transaction of a trustee, and found that though the trustee had violated his fiduciary duty to the beneficiaries of the trust, that the trustee was not liable because the settlor knew about the self-dealing acts and took no action to stop the trustee from continuing to engage in transactions in which the trustee had an interest. Id. at 1145.
54. Paddock v. Siemoneit, 218 S.W.2d 428, 432 (Tex. 1949). The proposition that the fiduciary duty of loyalty is more strict in trust law than it is in corporate law has been recognized by Delaware since as early as 1911. Eberhardt v. Christina Window Glass Co., 81 A. 774 (Del. Ch. 1911).
55. Paddock, 218 S.W.2d at 432.
proving that the transaction was both fair and in the beneficiaries' best interest.\textsuperscript{58} This standard is more akin to corporate law's intrinsic fairness or "entire fairness" test.\textsuperscript{59}

D. The crucial distinction

The distinction between the level of the fiduciary duty of loyalty owed by trustees versus the fiduciary duty owed by directors (and their differing standards of review) becomes important particularly in two situations: (1) when a trustee/director takes action in his own self-interest, but has approval from a majority of disinterested directors; and (2) when it could not otherwise be shown that a trustee stands on both sides of the transaction under question.\textsuperscript{60}

The Delaware Supreme Court's decision in\textit{Stegemeier v. Magness}\textsuperscript{61} is illustrative of both scenarios. In\textit{Stegemeier}, defendant Donald Magness, who was both a trustee and a director of a corporate trust, asserted that he could buy a parcel of real estate from the trust because the purchase was approved by other disinterested trustees. However, the court noted that this premise was "without merit because it is again predicated on fiduciary principles of corporate law, not trust law."\textsuperscript{62} The court noted that, according to trust law principles, a self-dealing transaction in breach of a fiduciary duty cannot be cured by garnering a majority of disinterested trustees' approval.\textsuperscript{63} Defendant Magness next argued that he had not violated his fiduciary duties by engaging in the purchase of trust property because the purchase could not be shown to be self-dealing.\textsuperscript{64} Self-dealing occurs, Magness argued, when an interested party can be shown to appear on both sides of the transaction.\textsuperscript{65} The Delaware Superior Court recognized, however, that "[t]he principles of trust law impose a higher standard than do the principles of corporate law. The Court further stated that "[u]nder trust law, self-dealing occurs when the fiduciary has a personal interest in the subject transaction of such a substantial nature that it might

\textsuperscript{58} Id. at 466.
\textsuperscript{59} Id.
\textsuperscript{60} \textit{Stegemeier}, 728 A.2d at 562.
\textsuperscript{61} 728 A.2d 557 (Del. 1999).
\textsuperscript{62} Id. at 565.
\textsuperscript{63} Id. The trust law principle that a self-dealing transaction cannot be cured by a disinterested majority's approval is in direct contradiction to corporate law. In McMillan v. Intercargo Corp., the Delaware Chancery Court held that a transaction in which one or more corporate directors are interested is not void or voidable solely for that reason, if the material facts are known to the other directors and the board in good faith authorizes the transaction by majority approval. McMillan v. Intercargo Corp., 768 A.2d 492, 502–503 (Del. Ch. 2000). Although three out of eight corporate directors were allegedly interested in the transaction at issue, the court noted that "[t]he presence of a disinterested board majority undercuts any inference that the decisions of the . . . board can be attributed to disloyalty," id. at 503.
\textsuperscript{64} \textit{Stegemeier}, 728 A.2d at 564. Specifically, the defendants argued that because Magness did not have the power to authorize the sale of the property, he had not engaged in self-dealing because it could not be shown that he stood on both sides of the transaction. \textit{Id.}
\textsuperscript{65} Id. at 562.
\textsuperscript{66} Id. at 564.
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have affected his judgment." Therefore, a party asserting that trustees are interested in a transaction need not show that the trustee stands on both sides of the transaction, but only that his interest was of such a nature that it might have affected his judgment in reaching his decision. Applying trust law principles and the entire fairness test, the court found that Donald Magness's interest might have affected his judgment, and that he therefore violated his duty of loyalty as a trustee.

III. SUMMARY OF THE COURT'S REASONING

In order to analyze the claim of breach of fiduciary duty brought by the beneficiaries of the trust against the trustees of CMD Realty Investor's, L.P., the Rhode Island Superior Court makes several central evaluations. The court frames the issue as whether the actions of the trustees in restructuring the organization of the management company are in compliance with their fiduciary duties as both trustees and directors. In order to resolve the issue, the court first defines the individual fiduciary duties of trustees and directors. The court then compares the kind of fiduciary duties of directors to those of trustees and finds that the duties are equivalent. After deciding that the fiduciary duties of trustees and directors are essentially similar, the court applies the business judgment rule and resolves that the trustees were acting within the discretion of their business judgment when they proposed the reorganization of the management company.

A. The court finds that the duties of trustees of a corporate trust are similar if not the same as the duties owed by directors of a corporation

The court first notes that, according to the terms of the trust document, it is proper for trustees and directors to be the same set of people. In grappling with whether or not the roles of trustees should differ from the roles and duties of directors in this situation, the court determines that the fiduciary duties of trustees and fiduciary duties of directors are essentially "similar, if not exactly the same." In equating these duties, the court states that "the differences between the two approaches may seem almost imperceptible because Trustees... of course also owe to the beneficiaries... the highest degree of good faith, care, loyalty and integrity. It is clear to the court that the [fiduciary duties of directors—good faith, loyalty, and due care—as associated with the business judgment rule,] are similar if not exactly the
same." The court does not otherwise support its conclusion that the fiduciary duties of trustees and directors are equivalent, nor does it further explore the distinction of degree that it made when the court noted that trustees owe the "highest degree" of fiduciary duties.

B. The court applies the business judgment rule to the trustee/directors' decision to reorganize the trust company

Having determined that the duties of trustees and directors are essentially equivalent, the court then inferentially concludes that the standards governing those duties are also equivalent. The court finds that the actions of the trustees can therefore be evaluated under the business judgment rule. The court states that because the business judgment rule "creates a rebuttable presumption that directors have acted properly," the beneficiaries must consequently prove that the directors have violated one of their fiduciary duties—either good faith, loyalty, or due care—in order to sustain their burden of overcoming the presumption that the directors' decision to reorganize the company is valid under the law. The court, utilizing corporate law principles, finds that the beneficiaries are unable to demonstrate that the trustees were interested in the proposed transaction, and thus holds that the reorganization of the management company is a proper exercise of the trustees' business judgment.

IV. ANALYSIS

Wood Prince required the Rhode Island Superior Court to analyze the fiduciary duties owed by the trustees of a corporate trust and the fiduciary duties owed by directors of a corporation when the individuals comprising those two groups are the same set of people. In attempting to define the fiduciary duties owed by trustees, on the one hand, and directors, on the other, the court generated a list of fiduciary duties. Comparing these duties, the court correctly determined that they were equivalent in kind and by name, but it then failed to distinguish that the fiduciary duties of trustees and directors are different in degree. It is vital that a

76. Id. at *5.
77. Interestingly, the very language the court uses to equate the two roles and duties with each other is markedly not the same -- for the court states that trustees owe the "highest" of fiduciary duties in comparison to the fiduciary duties owed by corporate directors. The court, however, then ignores its own use of the term "highest" by failing to further qualify this distinction in the degree of duties. Id. at *5–6.
78. Id. at *6.
79. Id. at *7.
80. Id. at *4.
81. The court equates the two standards when it states that "the Court should not substitute its judgment in place of the discretion afforded the Trustees... or [substitute] its Business Judgment for the Business Judgment inherent in the role of Trustees as directors." Id.
82. Id. at *8.
83. Id. at *4.
84. Id. at *5.
court be able to recognize that the fiduciary duty of loyalty is more stringently construed in trust law than it is in corporate law because that in turn effects the standard of review the court will employ to analyze the validity of a challenged transaction. A challenged transaction that calls into question a business decision made by directors will typically be analyzed under the business judgment rule (unless the challenging party can meet certain threshold requirements). A challenged transaction that calls into question a trustee's breach of his duty of loyalty, however, should be analyzed under a more demanding form of scrutiny that is closer to corporate law's "entire fairness" test. In making its broad and unsupported generalization that the fiduciary duties of trustees and directors are essentially "similar, if not exactly the same," the court both overlooked precedent and, as a result, incorrectly determined that the more deferential business judgment rule should apply to the trustees' proposed transaction.

A. The court mistakenly equated a director's duty of loyalty with that of a trustee

In analyzing the fiduciary duties of corporate directors and trustees, the court did little more than compose a laundry list describing the duties most commonly associated with each role. By relying strictly on this visual checklist of terms, the court overlooked precedent establishing that a trustee's fiduciary duty of loyalty is higher than that of a director. Even though the court had included on its own checklist that a trustee owes the "highest" of fiduciary duties, it ignored this distinction of degree when it later found that the duties of directors and trustees were essentially "similar, if not exactly the same." Instead, the court should have constructed a more detailed inquiry into the nature and degree of the duty of loyalty owed by a trustee versus that owed by a director. Had it done so, the court then may have evaluated the beneficiaries' claim under the more exacting trustee standard. If that standard had been used, at the very least, the court would have addressed the beneficiaries' claim with the appropriate legal and equitable concern that it was due; and, at the greatest, the court may have reached a different outcome entirely.

88. Id.
89. Id.
90. The court, because it had determined that the business judgment rule should apply and that the directors had acted within their appropriate business judgment when making the decision to reorganize the management company, did not present as detailed an analysis of the beneficiaries' claim of breach of loyalty as it would have had it recognized that a different standard of review applied. Therefore, it is difficult to postulate on the outcome of the case had the court employed the more exacting standard. Thus, although it appears from the record that the beneficiaries' allegation that the trustees had breached their duty of loyalty has merit, the court would need to directly address this evidence. It is possible that the trustees may, in fact, be able to rebut the beneficiaries' claim and meet their burden of proving the fairness of the reorganization of the management company. It is also possible that, applying the heightened standard and weighing all of the evidence, the court could find in favor of the beneficiaries.
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B. Claims of breach of loyalty garner heightened review under trust law principles; corporate principles are less stringent

Under trust law, a claim that beneficiaries of a trust bring against a trustee that alleges a breach of loyalty is examined under close scrutiny, and self-dealing on the part of the trustee is virtually prohibited. A transaction in which the beneficiaries allege that the trustees are interested is “not void, but voidable,” and a court will uphold such a transaction against a beneficiary challenge only if the trustee can show that the transaction was entirely fair.

In contrast, the restrictions placed upon interested transactions made by a corporation’s directors are less stringent. In fact, the central distinction between trust law and corporate law in this regard is that interested transactions made in the corporate context are not inherently wrong. Indeed, an interested transaction will be evaluated under the business judgment rule if either a majority of the board consisting of disinterested members approved the transaction, or if a majority of shareholders give their approval to the transaction. As long as a given transaction is fair to the corporation, it does not matter that some corporate officers or directors will profit as a result of the transaction.

The fact that some interested transactions are permitted under the corporate law system is in direct opposition to trust law, which holds interested transactions suspect. Under trust law principles, conflict of interest occurs when the fiduciary has a “personal interest in the subject transaction of such a substantial nature that it might have affected his judgment.” Central to the beneficiaries’ claim of breach of fiduciary duty in Wood Prince is the allegation that the corporate trustees proposed the reorganization of the management company in order to maximize their own return at the final distribution of the trust assets. Although the beneficiaries might not have been able to demonstrate that the trustees stood on both sides of the contemplated transaction (as corporate law usually requires), they could have demonstrated that the trustees had “a personal interest in the subject transaction of

92. Id. Some jurisdictions further require that beneficiaries must consent to such a transaction after receiving full disclosure of its terms. A court of equity, however, has the power to approve a transaction on behalf of the trust’s beneficiaries if it finds the transaction to be in their best interest. Equitable Trust Co. v. Gallagher, 102 A.2d 538, 545 (Del. 1954).
95. Oberly, 592 A.2d at 467.
98. Wood Prince v. Lynch, No. 03-1975, 2005 WL 373805, at *3 (R.I. Super. Feb. 8, 2005). The beneficiaries argued that the trustees’ duty of loyalty was called into question by several acts: (1) their authorization of a profit sharing plan with the senior management of the management company that could potentially detract from the profit garnered by the trust; and (2) that they proposed the reorganization in part as a result of their own self-interest in maximizing their return at the final distribution of the trust assets by ensuring that certain male beneficiaries could not adhere to the terms of the trust. Id. at *3–6.
such a substantial nature that it might have affected [their] judgment, as is the standard under trust law.

The court's failure to distinguish that trustees owe a higher degree of loyalty to the beneficiaries of a trust than corporate directors owe to their shareholders, as well as the court's resulting misapplication of the business judgment rule to the transaction in question, is problematic for the precedent that it creates. Subsequent courts may mistakenly follow this ruling, thereby weakening the tenets of trust law. Specifically, future director-trustees may take advantage of this court's ruling to shield themselves behind the deferential business judgment rule when claims are brought against them alleging a violation of their fiduciary duty of loyalty. According to the nature of this claim, and the high level of fiduciary duty that trustees owe to their beneficiaries, the court should not have automatically applied the business judgment rule to the beneficiaries' claim. Instead, the court should have more carefully examined the beneficiaries' claim utilizing the more exacting standard required by trust law in order to ensure the most equitable outcome.


100. Recall that in Stegemeir v. Magness, 728 A. 2d 557 (Del. 1999), the defendant argued that the beneficiaries of a trust could not show that he had engaged in self-dealing when the trust authorized a sale of real estate to the defendant, a trustee, because the defendant did not have the exclusive power to sell the property. Similarly, applying corporate law principles here, the directors-trustees in Wood Prince would not be self-dealing if they demonstrated that other directors (who are not trustees and who have no interest in the final distribution of trust assets) approved the reorganization of the management company. Applying trust law principles, however, (and assuming the beneficiaries can support their claim that the trustees would increase their own portions of the assets at the distribution of the trust by reorganizing the management company), the beneficiaries would need only to show that the trustees' interest in the final asset distribution played a motivating factor in their decision to reorganize the management company.

101. Presumably, they may be able to do this if they can demonstrate that they either: (1) are not self-interested within the meaning that corporate law gives to that term; (2) have the approval of a majority of the disinterested board; or (3) have shareholder approval. Imagine a situation similar to the facts of this case, where the beneficiaries of a trust bring a claim alleging that the dual director-trustees have violated their fiduciary duty of loyalty. Further imagine that the director-trustees comprise only two seats out of five on the board of the corporation. The board authorizes a reorganization of the company which would serve to preclude several family members who stand to benefit from the trust from gaining employment with the corporation. The beneficiaries then allege that the board's reorganization furthers the trustee-directors' own self-interest because it enhances their return at the cessation of the trust. The two trustee-directors may, according to the decision in Wood Prince, point out that, as trustees, they owe the same duty of loyalty that a corporate director owes, and that therefore the court should approach the issue as if it were analyzing a claim of breach of a director's loyalty by applying Del. Code Ann. tit. 8, § 144 (2001). The trustee-directors could then use section 144 to demonstrate that a majority of disinterested people on the board (the other three directors) approved the reorganization, and should be shielded from further scrutiny by the business judgment rule. Assume this occurs and the court approves their action. Several years later, however, at the time of the natural termination of the trust, the trust document is construed to read that only family members gainfully employed by the corporation may partake of its assets. The trustees, who are supposed to be the guardians of the trust assets and whose interests are subservient to those of the beneficiaries, have used the shield of the business judgment rule to cause these individual beneficiaries to lose out and have thereby gained at the final distribution of the trust assets. Such a result can hardly be called "fair."
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V. CONCLUSION

Failing to account for the differences between the fiduciary duties of trustees and directors, the Rhode Island Superior Court in Wood Prince gave too much deference to the trustees-directors when it applied the business judgment rule to the decision to reorganize the management company. By improperly applying the more deferential standard to the trustees' proposed transaction, the court gave greater weight to the principles of corporate law than it did to the principles of trust law. In effect, the court's holding opens the door for subsequent misapplications of the business judgment rule to allegations of trustee breaches of the fiduciary duty of loyalty which may prove to have disastrous and inequitable consequences for the beneficiaries of trusts.