Breach of Fiduciary Duty vs. Constructive Fraud

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Timothy "Tim" J.W. Muller

By Timothy "Tim" J.W. Muller on May 9, 2024

What happens when you rely on a financial or investment advisor to manage your investments only to find that they failed to act in your best interests and protect your money? You may have a legal remedy available to you under securities law.

Certain relationships require an individual or entity to protect the interests of another. This can arise in relationships between financial advisors and their clients, officers of a corporation and shareholders, and other similar relationships. When the party who owes a duty to another acts in a way that is adverse to that party, they may be liable for their actions under **breach of fiduciary duty** or constructive fraud.

Understanding the differences between a breach of fiduciary duty and constructive fraud is critical for navigating transactions, partnerships, and other business and financial agreements.

What is Fiduciary Duty?

A fiduciary duty is a legal obligation imposed on individuals or entities entrusted with specific responsibilities to act in a manner that is consistent with the best interests of another person or entity. The person who owes the duty is referred to as the "fiduciary," while the person to whom the duty is owed is known as the "beneficiary" or "principal." These relationships involve a duty of care, a duty of loyalty, and an obligation to refrain from behaviors that may harm the beneficiary.

In the context of securities law, fiduciary duties often arise in the relationships between parties involved in the sale and purchase of securities.

Examples of these relationships include:

- **Investment Advisors**: Investment advisors owe fiduciary duties to their clients. This means they must act in their client's best interests, disclose any potential conflicts of interest, and provide sound investment advice.
- **Corporate Officers and Directors**: Officers and directors of publicly traded companies owe fiduciary duties to their shareholders. They must act with due care, loyalty, and good faith in managing the company's affairs and disclosing material information to shareholders.

What is Constructive Fraud?

Constructive fraud occurs when a person or entity gains an unfair advantage over another to whom they owe a fiduciary duty by unjust means including lying or omitting relevant information. It refers to a breach of duty through material misrepresentation upon which a third party relies. The elements of constructive fraud are a relationship of trust and confidence that existed at the time, the defendant took advantage of that position of trust, and there was an injury to the plaintiff.

Examples of constructive fraud include:

- Misleading or omitting material information in financial statements or disclosures.
- Insider trading or other forms of market manipulation.
- Breach of fiduciary duty by corporate insiders for personal gain at the expense of shareholders.

Actual Fraud vs. Constructive Fraud

Another key distinction to understand is the difference between actual fraud and constructive fraud. Actual fraud requires an intent to deceive. It occurs when someone knowingly makes false representations or conceals material facts with the intent to deceive another party. To prove actual fraud, there must be proof that the defendant had the intent to deceive or defraud the plaintiff. They must have made false statements both knowingly and with the intent to induce detrimental reliance. This can arise when a party intentionally misrepresents the value of assets during a transaction, leaves out critical information when negotiating a contract, or falsifies financial documents.

Constructive fraud, on the other hand, does not require proof of intent to deceive. This means that it is much easier to prove and relies more on the breach of a fiduciary duty owed to another party. This focuses on unjust enrichment in which one party benefits at the expense of another due to that breach of duty.

What are the Differences Between Constructive Fraud and Fiduciary Duty?

A breach of fiduciary duty focuses on the relationship between the fiduciary and the beneficiary. It emphasizes the finding of a failure to fulfill obligations owed to the beneficiary. Whereas constructive fraud emphasizes the unjust enrichment or advantage gained due to the defendant’s conduct.

Litigation of Constructive Fraud and Breach of Fiduciary Duty

So, what does this look like in practice? In the context of securities law, when fiduciary duties are breached, or constructive fraud occurs, the following situations may occur:

1. Plaintiffs may allege breaches of fiduciary duties by corporate officers, directors, or invesment advisors, resulting in financial losses for investors.
2. Courts evaluate whether defendants engaged in conduct constituting constructive fraud, even without explicit fraudulent intent.

3. Remedies in securities litigation may include disgorgement of profits, damages, injunctions, or other equitable relief to compensate harmed investors and deter future misconduct.

Charleston Securities Litigation Lawyers

The business and commercial litigation lawyers at Rosen Hagood have experience representing individual investors and handling a variety of securities actions on behalf of clients. For help with your case, **contact Rosen Hagood** to speak to an experienced **securities litigation** lawyer.

