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Commercial division update – Fiduciary duties arising from close personal relationships

Thomas J. Hall and Thomas R. Commons, *New York Law Journal – June 14, 2018*

This column addresses recent decisions out of the New York Supreme Court's Commercial Division that target exactly that question, whether fiduciary duties may arise as a result of a close personal relationship between parties.

It is well-settled in New York that a fiduciary relationship arises between two persons when one of them is under a duty to act for, or to give advice for the benefit of another, upon matters within the scope of the relation. *Roni LLC v. Arfa*, 18 N.Y.3d 846 (2011). Oftentimes, a fiduciary relationship arises out of a formal agreement between the parties. Classic examples include relationships between attorneys and their clients, physicians and their patients, and corporate directors and their corporations. New York courts have also acknowledged, however, that a fiduciary relationship can be created informally under "special circumstances." These informal relationships require a much more fact-intensive analysis by the courts to determine if the parties owe certain fiduciary duties to one another. Recently, the Commercial Division has grappled with the question of whether a close friendship could be the kind of special circumstances that can give rise to fiduciary duties.

Informal Relationship Analysis

In the absence of a formal fiduciary relationship between the parties, a relationship can impose fiduciary duties on the parties only in special instances that effectively transform the parties' relationship into a fiduciary one. *American International Group, Inc. v. Greenberg*, 23 Misc. 3d 278 (N.Y. Co. 2008). For these reasons, the question of whether fiduciary duties arise from an informal relationship requires a highly fact-intensive analysis. Typically, New York "Courts weigh the substance of the parties' relationship, including the closeness and ongoing nature of the contacts."

The cornerstone of such an analysis, however, is trust. "A fiduciary relationship whether formal or informal, is one founded upon trust or confidence reposed by one person in the integrity and fidelity of another," *see Koether v. Sherry*, 40 Misc. 3d 1237(A) (Kings Co. 2013). This type of relationship exists where one party reposes trust in another and, reasonably relies on the other's superior expertise or knowledge. By placing the entirety of one's faith into the opinion of another party, it typically establishes a relationship in which the parties become duty bound to act or give advice in the best interest of the other.

In the past, New York courts have briefly acknowledged that friendship could form the basis of a fiduciary relationship, but these courts only addressed the issue in the abstract.

In *Penato v. George*, 52 A.D.2d 939, 942 (2d Dep't. 1976), in denying a motion to dismiss, the court recognized that friendship can form the basis for the existence of a fiduciary relationship, but did not analyze the relationship at issue or explain what kind of friendship gives rise to fiduciary obligations. There, the court ultimately concluded that it was impossible to say that the plaintiff would be unable to prove the existence of a fiduciary relationship at that juncture. Similarly, in *Kohan v. Nehmadi*, 130 A.D.3d 429, 430, (1st Dep't. 2015), in affirming a denial of a motion for summary judgement, the court acknowledged that friendship could be used as a basis to impose a constructive trust (which in itself requires the repudiation of a fiduciary obligation), without actually examining the specific friendship in question. While in the past some courts have been willing to acknowledge that a close personal friendship could create a fiduciary relationship, they typically did so without providing a specific analysis on the interaction between close personal relationships and fiduciary duties.

Recent Developments

In the 2013 decision in *Koether*, the Commercial Division did consider, albeit briefly, whether an informal fiduciary relationship can be formed simply as a result of a close personal friendship. There, Justice Carolyn Demarest of the Kings County Commercial Division found that a close personal friendship may give rise to an informal fiduciary relationship because, often, these relationships are exactly of the sort where one party wholly trusts the other and reasonably relies on the other party's expertise or knowledge of a situation. Justice Demarest went on to qualify her analysis by explaining that, while a friendship between the parties may be a factor in determining the existence of a fiduciary relationship, a friendship or social relationship, in and of itself, does not establish such a relationship. The existence of a personal relationship, however, remains useful to the analysis as it can be used to illustrate that one party placed a high degree of trust and confidence in the other party. Further, the duration and closeness of the relationship between the parties has the potential to act as a stand-in, in the absence of a formal business relationship or agreement between the parties.

Following the decision in *Koether*, this year Justice Barry Ostrager of the New York County Commercial Division took the opportunity to shed more light on this somewhat murky area of New York law. In *Pai v. Blueman Group Publishing*, 2018 WL 1363410 (N.Y. Co. March 16, 2018), Justice Ostrager was tasked with determining whether a long-standing close personal relationship between the plaintiff and defendants gave rise to a fiduciary duty owed by the defendants to look out for financial interests of the plaintiff There, the plaintiff, a then aspiring and naïve musician, first met the defendants, then three little-known performance artists, in the late 1980s, and the group began collaborating on a project that would later evolve into the world-famous Blue Man Group. This initial interaction became the catalyst for a decades-long friendship between the parties.

This relationship ultimately deteriorated in 2014 when the plaintiff first learned that the royalty checks he received for his service on the project were to be cut in half due to a change in the methodology the defendants had been using to calculate the plaintiff's royalties. The plaintiff ultimately brought suit for, among other things, a breach of fiduciary duties claiming that he had become very close friends with the individual defendants over the years and had depended on their repeated assurances that he was being compensated fairly for his contributions to the Blue Man Group.

In granting summary judgment dismissing the fiduciary duty claim, Justice Ostrager first acknowledged that a fiduciary relationship "might be found to exist, in appropriate circumstances, between close friends or even where confidence is based upon prior business dealings." He further acknowledged that there was ample evidence from the defendant Blue Man Group founders confirming the tight-knit relationship that developed between them and the plaintiff, and even that the plaintiff, as an enthusiastic twenty-year-old artist trying to succeed in New York City, would have placed a significant amount of trust in the individual defendants who were basically his contemporaries. Justice Ostrager stopped short of finding, however, that the defendants could have breached of any sort of fiduciary duty because, after 1999, the plaintiff began consulting independent counsel on a range of matters related to the Blue Man Group. The court explained that there may have been a fiduciary relationship between the plaintiff and the individual defendants through much of the 1990s given the plaintiff's age, lack of financial experience, and trust in the individual defendants to look out for him, but that any such fiduciary relationship ceased to exist when plaintiff began consulting attorneys seeking independent advice. By that point, the defendants were not in a position of dominance over the plaintiff such that they owed any fiduciary obligations to him. Justice Ostrager dismissed the claim because any fiduciary duty claim the plaintiff may have had in the 1990s was time barred under the applicable six-year statute of limitations.

Despite not expressly holding that a close-friendship in fact gave rise to fiduciary duties, the decision remains a significant step in this area of law as it illustrates that such a relationship has the potential to be one of the "special circumstances" necessary to bring about fiduciary duties.

Scholarly Interpretations

These recent Commercial Division decisions have the potential to alter the landscape of fiduciary law in New York. Some scholars have urged for some time that this would be a welcomed change. To that end, it has been argued that certain friendships are undoubtedly relationships "of trust and vulnerability, and fiduciary law is set up specifically to give effect to and frame [these] sort[s] of special relationship[s]." Ethan J. Leib, *Friends as Fiduciaries*, 86 WASH. U. L. REV. 665, 732 (2009). A close friendship brings with it a disarming nature, and, one commendation stated, "courts should embrace the idea that [such] friendships should be able to trigger certain fiduciary duties without a separate showing of 'dominance' or 'undue influence.'" Finally, by recognizing certain friends as fiduciaries, it may help to provide courts with the means necessary to institute justice for betrayed friends in certain contexts. Others argue, however, that friendships should not be regulated since these relationships are often extremely complex and multifaceted, which makes it too difficult for courts to effectively analyze what obligations friends owe one another and what remedies should be available to the aggrieved party, *see* Eric A. Posner, *Huck and Jim and Law* (https://newrepublic.com/article/79522/friend-transformation-ethan-leib), The New Republic, (last visited June 8, 2018).

Conclusion

While the Commercial Division has been cautious to find that certain friendships inherently create fiduciary duties, recent opinions should signal to litigants on both sides that such a conclusion remains a possibility in certain circumstances. Future decisions on this issue will no doubt help mold the contours of this doctrine.

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