Cargill, Incorporated, et al. v. JWH Special Circumstance LLC

November 2008

For the first time since the enactment of the Delaware Statutory Trust Act (the "DSTA") more than twenty years ago, a Delaware court has addressed fiduciary duties in the context of a Delaware statutory trust. In *Cargill, Incorporated v. JWH Special Circumstance LLC*, C.A. No. 3234, Parsons, C. (Del. Ch. Nov. 7, 2008), the court held that a corporate parent that exercises dominion and control of a fiduciary of a statutory trust owes a duty of loyalty directly to the trust in certain circumstances absent provisions in the governing instrument to the contrary. In so doing, the court extended the holdings of a line of partnership cases, beginning with *In re USACafes, L.P. Litigation*, 600 A.2d 43 (Del. Ch. 1991), to statutory trusts.

Cargill involved allegations that a statutory trust, JWH Global Trust (the "Trust"), suffered significant losses as a result of a transfer of certain of its assets to the Refco Group shortly before Refco's collapse in late 2005. The transfer of the Trust's assets was part of a larger sale of assets by Cargill, Inc. ("Cargill"), an indirect parent of the managing owner of the Trust, and the case centered around allegations that Cargill improperly exerted control over the Trust to facilitate the larger sale to serve Cargill's self interest. The *Cargill* case is notable not only because it addresses an issue of first impression in Delaware (in addition to being only the second published case in Delaware interpreting the Delaware Statutory Trust Act) but also because it contains discussions of the policies underlying the Delaware Statutory Trust Act, the duties that may be applicable to a fiduciary of a statutory trust, and whether those duties may be eliminated or modified, all of which provide guidance with respect to how Delaware courts will approach future statutory trust cases.

Facts of the Case

The Trust is a publicly registered commodities pool that trades futures and forwards contracts on currencies, interest rates and various commodities. During the periods relevant to the case, the Trust's managing owner was CIS Investments, Inc. (the "Managing Owner"), which was an indirect subsidiary of Cargill and a direct subsidiary of Cargill Investor Services, Inc. ("CIS" and together with Cargill, the "Cargill Plaintiffs"). The Managing Owner had no employees other than those also employed by Cargill or CIS, and its officers and directors received their salaries and benefits from Cargill or CIS.

In 2005, Cargill sold, among other things, its ownership interest in the Managing Owner to Refco, Inc. — an entity apparently infamous in the industry because of a checkered past that included multiple multimillion-dollar fines by the Commodities Futures Trading Commission relating to the improper use of customer accounts. In connection with the closing of the sale, a number of the Trust's accounts were to be transferred from the Trust's immediate parent to a Refco affiliate. These transfers required the Trust's consent. Though not entirely clear from the opinion, it seems that the request for the Trust's consent was transmitted by a law firm (which

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was representing each of the Managing Owner, the Trust and Refco) to an officer of both the Managing Owner and its parent, CIS. The consent was perfunctorily given without the benefit, the court noted, of independent legal advice on behalf of the Trust or an independent analysis of what was in the best interests of the Trust.

Soon after the sale closed, Refco publicly announced that it had a fraudulent receivable from an affiliate on its books, which, among other things, triggered a run on funds held by the Refco affiliate that had received the Trust's accounts in the sale. This in turn resulted in the discovery that the Refco affiliate had misappropriated the Trust's accounts to finance Refco's overall business operations. Soon after, Refco and certain of its affiliates filed for bankruptcy and shortly thereafter were liquidated. The Trust lost approximately $35 million in the process.

In 2007, JWH Special Circumstance LLC ("JWH") provided a draft complaint to the Cargill Plaintiffs which it intended to file in Minnesota against them in order to seek recovery on behalf of the Trust. Before it could file that complaint, however, the Cargill Plaintiffs commenced an action in Delaware for a declaratory judgment of no liability. JWH counterclaimed, alleging that the Cargill Plaintiffs (i) breached fiduciary duties they owed to the Trust, (ii) aided and abetted breaches of fiduciary duty committed by the Managing Owner, and (iii) were negligent. Only the first of these three claims is discussed in this case summary because it is the only claim where the court had reason to discuss the DSTA at length. The court's opinion was a ruling on a motion to dismiss and for judgment on the pleadings.

Claims against Cargill Plaintiffs for Direct Breaches of Fiduciary Duties

Though only one of three claims in the case, the court spent the bulk of the opinion discussing JWH's theory of direct fiduciary liability, which was premised on the *USACafes* line of cases. Those cases established that a corporate parent of a fiduciary that exercises dominion and control of a fiduciary of an underlying entity in connection with a transaction that benefits the corporate parent at the expense of the underlying entity may owe fiduciary duties to the underlying entity in connection with the transaction. After dismissing out of hand the Cargill Plaintiffs' contention that Delaware law imposed no default duties on a corporate parent in the statutory trust context absent a positive statement in the trust agreement, the court analyzed JWH's theory of liability by considering whether: (i) the trust agreement preempted default common law duties, (ii) the DSTA preempted default common law duties, and (iii) there were default common law duties applicable to the Cargill Plaintiffs in the first place.

1. Did the Trust Agreement Preempt Common Law Duties?

The court prefaced its analysis of the trust agreement by noting that the DSTA's stated policy is to give maximum effect to the principle of freedom of contract and that the provisions of the DSTA permit a trust agreement to expand, restrict or eliminate fiduciary duties subject to the implied covenant of good faith and fair dealing. The court then began its analysis with an examination of the trust agreement to determine the parties' intent. The bulk of the court's discussion that followed centered on a provision of the trust agreement addressing the liability of affiliates of the Managing Owner. The court ultimately concluded that the provision was an exculpatory provision and not a provision addressing what fiduciary duties applied to the Cargill Plaintiffs in the first instance. It further concluded that the provision only applied in certain specified situations arguably not applicable to the case. The court stated that the provision did not address fiduciary duties, adding that "[t]he failure to exculpate an entity for breach of a duty does not necessarily mean the entity had no duties in the first place."

2. Did the DSTA Preempt Common Law Duties?

The court then turned to the DSTA and analyzed whether it preempted default fiduciary duties. The court first noted that Section 3809 of the DSTA provides that the laws that apply to trusts generally also apply to statutory trusts unless the DSTA or the trust agreement provide otherwise. It then turned to an analysis of Section 3806(a) of the DSTA, which the Cargill Plaintiffs argued precluded a finding of any duty because the section provides that the ability to give direction does not cause someone to be a trustee (and thus does not cause someone to be a fiduciary). Perhaps providing an implicit acknowledgement of the strength of the Cargill Plaintiffs' position, the court devoted six pages of a sixty-page opinion to considering four sentences of Section 3806 (citing a treatise by Richards, Layton & Finger directors Balotti and Finklestein in the process) before ultimately rejecting the Cargill Plaintiffs' arguments and concluding that the statute requires a provision in the trust agreement to override any fiduciary duties of those who have control over a fiduciary.

3. Did the Cargill Plaintiffs Owe a Duty to the Trust?

Finally, after concluding that neither the trust agreement nor the DSTA preempted default common law duties owed by corporate parents of fiduciaries, the court turned to considering whether any such duties existed at common law in the context of a statutory trust. JWH's theory was that the principles of *USACafes* and its progeny should be extended to statutory trusts because that line of cases explicitly relied upon fiduciary duty theories derived from trust law concepts. Without much analysis, the court agreed that in principle the *USACafes* cases were applicable to statutory trusts. The court was careful to limit its holding solely to the concept of there being a duty of loyalty consisting of a duty not to use the power to control the Trust or its property at the expense of the Trust. The bulk of the remainder of the court's opinion was devoted to analyzing whether the alleged facts sufficiently indicated control by the Cargill Plaintiffs for their own benefit at the expense of the Trust.