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California Law Review

MAY, 1983

71 Calif. L. Rev. 795

ARTICLE: Fiduciary Law.

Tamar Frankel +

+ Professor of Law, Boston University. LL.M. 1964, Harvard University; S.J.D. 1972, Harvard University.

I am indebted to Professors Paul M. Bator, Victor Brudney, Robert C. Clark, Alfred Conard, Duncan Kennedy, Penina Lahav, and Louis Loss for their comments and counsel in connection with this Article. I am also grateful to William Schwartz, Dean of the Boston University School of Law, for his support of the research on this Article.

SUMMARY:

... In the business realm, the fiduciary duties of partners, corporate directors, and officers originated with the formation of partnerships and corporations, but majority shareholders were not subjected to fiduciary duties until this century. ... As in a status relation, one party to a fiduciary relation (the *entrustor*) is dependent on the other (the fiduciary). ... For example, a trust is defined as a fiduciary relation in which property is transferred to the trustee. ... A trustee is chosen by the trustor, and must be able to manage the trust assets independently of the beneficiary's control. ... It further shows that the protective mechanisms outside of fiduciary law cannot adequately eliminate this risk to the entrustor. ... Therefore, the entrustor-shareholder in a fiduciary relation with a corporate director is much more vulnerable to abuse of power than is the entrustor-employer in his relation with the employee. ... The previous Part identified the potential for abuse of power that exists in every fiduciary relation, and showed that alternatives to fiduciary law may be inadequate to protect the entrustor against the abuse. ... Because it is costly to find a fiduciary whose interests are identical with those of the entrustor, much of fiduciary law is designed to prevent the fiduciary from using delegated power to further interests other than those of the entrustor. ...

TEXT:

Fiduciaries appear in a variety of forms, including agents, partners, directors and officers, trustees, executors and administrators, receivers, bailees, and guardians. These fiduciaries are found in many areas of the law, such as criminal and labor, securities and corporations, contracts, partnerships, and trusts. The various fiduciaries, as well as the rules that govern them, share obvious and identifiable similarities, although there are marked differences among them.

An examination of the differences and similarities among fiduciaries is complicated by the fact that the various types of fiduciaries is complicated by the fact that the various types of fiduciaries have evolved over the centuries. Trustees, administrators, and bailees are of ancient origin, ⁿ¹ whereas agents appeared only at the end of the eighteenth century. ⁿ² In the business realm, the fiduciary duties of partners, corporate directors, and officers originated with the formation of partnerships and corporations, ⁿ³ but majority shareholders were not subjected to fiduciary duties until

this century. n4 Union leaders were cast in the fiduciary role at a still later date, when they acquired the statutory power to represent workers in negotiations with management. n5 The twentieth century is witnessing an unprecedented expansion and development of the fiduciary law. For example, physicians and psychiatrists have recently become members of the fiduciary group, n6 and one commentator has suggested trust law as a model for the relations between the state, parents, and children. n7

Traditionally, the various types of fiduciaries have been studied in the context of the specific substantive areas of law in which they appeared. n8 Few scholars have examined fiduciary legal principles separately from these specific contexts. Little has been written about the origin of fiduciary law, the rationales behind the creation of fiduciary duties, the remedies for violations of these duties, and the methods by which courts fashion such remedies. n9

It could be argued that we should continue to deal with each species of fiduciary separately. Even though fiduciaries share some characteristics, there may be no advantage in studying fiduciaries apart from their usual legal contexts. The differences among fiduciaries may be so great that treating them as a group would require a very high level of generality, rendering a unified examination of little use. Moreover, a general theory might offer a temptation to force all fiduciaries into a theoretical straitjacket, thus sacrificing the flexibility of a more particularized approach.

I submit that there are two important justifications for recognizing fiduciaries as a group and for recognizing the law that governs them as a distinct body of policies, principles, and rules. First, fiduciary law is becoming more important as it responds to basic changes in our society. Courts, legislatures, and administrative agencies increasingly draw on fiduciary law to answer problems caused by these social changes. n10 Second, the current methods of developing this important body of law -- analogizing to preexisting fiduciary relations -- are unsatisfactory because the analogies frequently do not result in appropriate rules.

The purpose of this Article is to inquire into the nature of fiduciary relations and the policies, principles, and rules that govern them. Part I discusses status, contract, and fiduciary relations. It shows that fiduciary relations are sufficiently distinct and important in our society to warrant treating the law applicable to them as a separate area of the law. Part II examines fiduciary relations and their common characteristics, and concludes that all these relations pose the problem of abuse of delegated power. Part III discusses legal regulation of fiduciaries as a means by which the law can address the problem of abuse of power. Finally, Part IV proposes a model for fiduciary law that provides incentives for parties to enter the relations by maximizing both their benefits and freedom of choice.

I

THE IMPORTANCE OF FIDUCIARY RELATIONS AND FIDUCIARY LAW

A. The Rise of the Fiduciary Society

Societies may be distinguished by the predominant social and legal relations through which their members interact. This is not to suggest that only one kind of relation exists in any given society, but merely that in each society one type of relation is paramount, and that, as social trends change, relations tend to shift and merge. Although it is probably incorrect to say that societies have evolved in a linear manner according to their predominant social relation, i.e., from status to contract to fiduciary relations, one can observe changes in a society's basic relations.

Law should reflect the changes in societal structure. Thus, a major reason for recognizing and developing a separate body of fiduciary law is that our society is evolving into one based predominantly on fiduciary relations. The body of law governing fiduciary relations can affect and be affected by this social trend.

Fiduciary relations and the rules that govern them can be better understood when compared to two other important relations: status and contract relations and the laws that govern them. The comparison involves three features. The first deals with the contribution of each type of relation to each party's needs and desires. The comparison deals, second, with the effect of the relation on the balance of power between the parties. The two are interrelated. While a relation with others is essential to each party's survival, n11 such a relation may also create a dependence of one party on another, that can in turn limit the freedom of choice of the person who is dependent. The third feature with which this comparison deals is the role of law in the relation, and its effect on the provision of each party's needs, on each party's freedom from coercion by the other, and on the structure and promotion of the relation.

1. Primary Social Relations

a. Status

The parties to a status relation must rely on each other to satisfy their needs and desires. In a status relation, such as that of parent and child, one party (the Power Bearer) usually has a partial or full monopoly over the means for satisfying the needs of the other party (the Dependent). The Power Bearer can coerce the Dependent into service and obedience by manipulating, increasing, or decreasing the satisfaction of the Dependent's needs. As a result of the Power Bearer's monopoly, the Dependent generally defers to the will of the Power Bearer in order to ensure the means for his own survival.

Although the Power Bearer may attempt to minimize the care he gives and maximize the service he extracts, the Power Bearer takes care of the Dependent in order to ensure the Dependent's services or other benefits from the relation for himself. In other words, the Power Bearer furthers his own interest by avoiding gross abuse of his power over the Dependent. In sum, in status relations the Power Bearer dominates the Dependent and the Dependent's freedom is limited in order to ensure the means for his survival, but the Power Bearer must also limit abuse in the exercise of his power in order to meet his own needs.

The law plays a crucial role in the establishment of a status relation. To a substantial extent, the law rather than the parties determines the entry and exit from the relation. Moreover, the law vests power in the Power Bearer and even supports a monopoly on the power. The law rarely interferes in the exercise of the power, setting only broad outer limits and leaving the Dependent with few or no alternatives for satisfying his needs. In most status relations, the law gives higher priority to the security of both parties than to freedom for the Dependent.

b. Contract

The parties to a contract relation must also rely on each other to satisfy their needs or desires. Unlike the parties in a status relation, however, neither can use force or monopoly to achieve his purpose. Instead of asserting personal dominance over the other party, each party must persuade the other to exchange. Nevertheless, the parties are in conflict, as each party must protect himself from the other's self-interested behavior.

Unlike the parties in status relations, contract parties have many options for satisfying their needs. They determine their own needs, they bargain to obtain them, and they can enforce their bargains. The law provides each party to a contract with equal legal freedom to make independent decisions as to what to bargain for, and what to give in exchange. Contract frees each party from domination by the other, making them more independent than in a status relation; but its price is the absence of security. No party to a contract has a general obligation to take care of the other, and neither has the right to be taken care of.

The main role of the law in contract relations is to prohibit the use of force and monopoly, and to enforce the rules the parties freely set for themselves. The law does not make the rules or the contract, although it may facilitate the bargaining process. In addition, the law encourages markets to offer numerous options to each individual from which to satisfy his needs by exchange.

c. The Fiduciary Relation

As in a status relation, one party to a fiduciary relation (the *entrustor*) is dependent on the other (the fiduciary). This dependence, however, is seldom as broad and pervasive as that in status relations. By definition, the entrustor becomes dependent because he must rely on the fiduciary for a particular service. The fiduciary, however, does not provide every service that the entrustor may need or desire.

Furthermore, the fiduciary himself is not independent, except perhaps in the area of his particular function. He must seek other fiduciaries for other services. For example, money managers generally rely on physicians for medical treatment, while physicians may look to managers for investment advice. Thus, in a society with many types of fiduciaries, each person may sometimes be a Power Bearer and at other times be a Dependent. Like a prospective party to a contract, an entrustor often can choose among alternative fiduciaries and negotiate the terms of the relation. A fiduciary rarely has a monopoly over the entrustor's needs. Moreover, unless the entrustor agrees, the fiduciary cannot manipulate the terms of his performance once the relation has been established.

In contrast to contract and status relations, in which both parties seek to satisfy their own needs and desires through the relation, fiduciary relations are designed not to satisfy both parties' needs, but only those of the entrustor. Thus, a fiduciary may enter into a fiduciary relation without regard to his own needs. Moreover, an entrustor does not owe the fiduciary anything by virtue of the relation except in accordance with the agreed-upon terms or legally fixed status duties. Therefore, in a fiduciary relation, the entrustor is free from domination by the fiduciary, although he may still be

coerced in parallel status relation. Thus, fiduciary relations combine the bargaining freedom inherent in contract relations with a limited form of the power and dependence of status relations.

Accordingly, the law of fiduciary relations should, if possible, preserve the best aspects of status and contract relations. It is desirable for the entrustor to depend on the fiduciary to satisfy certain needs. But it would not be desirable for fiduciary law to impose the relation on either law should permit the parties to enter into the relation freely and to ensure that the fiduciary will not coerce the entrustor. The model of fiduciary law that is built in the remainder of this Article seeks to achieve these goals.

2. Status, Contract, and Fiduciary Societies

One is tempted to follow in Sir Henry Maine's footsteps and state that there has been an evolution from status to contract to a fiduciary society. ⁿ¹⁹ Yet as a matter of history, Maine's thesis is subject to criticism. ⁿ²⁰ Societies are too complex, diffuse, and many-faceted to sustain a theory of linear societal evolution. Nevertheless, a society's entire structure can be influenced by its predominant relation. I believe it is therefore safe to assert that certain societies are more suited to particular types of relations, and that an examination of these societies can demonstrate how these relations work.

A feudal society, such as the one that existed in England during the Middle Ages, is based primarily on status. Such a society is static, because the status of Power Bearers and Dependents is predetermined by law. Furthermore, in a status society Dependents have few options for taking care of themselves, making their security precarious. Finally, personal dominance of one individual over another is common and accepted in such a society.

In a contract society, individuals ⁿ²¹ can provide for their basic needs, and can gain by exchanging the surplus they produce. In addition, such a society offers many options for its members to satisfy their needs. A contract society values freedom and independence highly, but it provides little security for its members. An example of a society based primarily on contract is the market society of the United States during the Industrial Revolution.

I submit that we are witnessing the emergence of a society predominantly based on fiduciary relations. This type of society best reflects our contemporary social values. In our society, affluence is largely produced by interdependence, ⁿ²² but personal freedom is cherished. Society's members turn to an arbitrator, the government, to obtain protection from personal coercion by those on whom they depend for specialized services. A fiduciary society attempts to maximize both the satisfaction of needs and the protection of freedom.

Unlike status and contract societies, a fiduciary society emphasizes not personal conflict and domination among individuals, but cooperation and identity of interest pursuant to acceptable but imposed standards. It permits the government to moderate between altruistic goals and individualistic, selfish desires, as well as between the social goal of increasing the common welfare and the individual desire to appropriate more than a "fair share."

B The Role of Fiduciary Law

1. Fiduciary Law and Social Change

There are several discernible social trends that are increasing the importance of fiduciary relations and the law that governs them. One trend is the decline of legal and social controls over those who offer services. We are turning to fiduciary law to replace social controls that have weakened. For example, as long as minors, apprentices, or household members were subject to their master's life-and-death power, the master could control the performance of their functions. As these individuals ceased to live on the master's estate, the master lost physical and legal controls over them. In response, the law reclassified these status relations as agency relations, substituting fiduciary duties for the lost controls. ⁿ²³

Another social trend which increases the importance of fiduciary law is the change in perception of power, ⁿ²⁴ and the emergence of new forms of power. These new forms, which are associated with post-industrial America, are important to our society because they promote individual welfare and increase the efficiency of the resource allocation. Two most notable new forms of power stem from the social trends of specialization and pooling.

Specialization of labor has become one of the main features of our modern society. Specialization is important because it maximizes the benefits from labor. For example, if A uses B's skills in managing his property, the arrangement enhances the value of the property if B is more skillful than A, or even if A and B are equally skilled but B has more time to manage the property. ⁿ²⁵ The employment arrangement between A and B also enables A to devote more time to tasks he can perform better or to leisure, which he may value. Specialization is also important because,

with the dramatic growth of available knowledge, it is becoming increasingly difficult for any individual to be proficient -- or even competent -- in all fields. Society benefits from specialization because it increases the total amount of available expert services. Specialists offer their services to the public, and draw on other specialists for their own needs in fields where they lack expertise. In fact, the specialist becomes the substitute for all those in society who seek his expertise. n26

Another important social trend, which is related to specialization, is pooling: the transfer of resources by many persons to a small number of experts. Pooling benefits the participants because it may produce economies of scale, shift risk from individuals to larger groups, and create the means of accomplishing projects that individuals with isolated resources could not undertake.

Financial institutions present one example of the benefits of pooling. Rather than having each potential borrower engage in the costly process of finding a saver who matches his needs in terms of amounts, maturity dates, and levels of risk, financial institutions pool savings, and thus at a lesser cost are able to provide loans with terms that suit the varied needs of both borrowers and savers. These institutions serve society by channelling resources into productive uses.

Relations that stem from specialization and pooling are often classified as fiduciary because they pose the problem of abuse of power that is common to fiduciary relations. In specialization and pooling arrangements, as in fiduciary relations, one party substitutes for and obtains delegated power from another. All these types of arrangements require one party to perform services that the other might have performed himself, but that he finds more advantageous to have performed by others. Furthermore, all require the fiduciary to use delegated power to facilitate his service to the other. All pose the possibility of abuse of that power.

2. Current Methods of Developing Fiduciary Law

The previous Section argued that one reason for treating fiduciary law as a distinct body of law is the growing importance of fiduciary relations in our society. A second reason is that this treatment will help provide a better method for developing fiduciary law than the present methods do. Courts currently examine existing prototypes, such as agency, trust, or bailment that are defined as fiduciary. Then, courts create rules for new fiduciary relations by drawing analogies with these prototypes. I maintain such a method of developing fiduciary law is unsatisfactory. A new approach is necessary in order to provide a better analytical framework for the law.

Traditionally, the courts have developed fiduciary law by defining various relations as fiduciary and designing rules for these relations. The definitions merely describe the arrangements that the parties establish and bring before the courts. For example, a trust is defined as a fiduciary relation in which property is transferred to the trustee. n27 The trustee is free from the beneficiaries' control, and their consent is not necessary to establish the relation. n28 Similarly, agency is defined as a consensual arrangement under which one party acts on behalf of another, subject to the other's control. n29

This method of developing the law was adequate in the past because new types of fiduciaries were recognized gradually over the centuries. The "use" emerged during the twelfth and thirteenth centuries in England, n30 and the trust developed over the fourteenth through seventeenth centuries. n31 Partnerships appeared in the sixteenth century, and evolved into joint stock companies and corporations. n32 Emancipated servants and employees emerged from domestic relations law to become agents and factors. n33 It was therefore sufficient to describe an arrangement, call it fiduciary, and decide on appropriate rules.

As the number of relations similar to existing fiduciary relations increased, the courts began to analogize the new relations to the established fiduciary prototypes, and to apply the rules of the prototypes to the new relations. Corporate law, for example, frequently analogizes directors to trustees, agents, and managing partners. n34 But such analogies are uninformative, because the courts do not explain why some similarities between directors and trustees are relevant and others not. Furthermore, analogies are not helpful in solving specific problems that new situations pose, because the rules that apply to the old prototypes do not necessarily respond to the problems posed by the new ones.

In addition, the courts are inconsistent in choosing their analogies. One decision, for example, held that directors are trustees, and applied trust rules against self-dealing to them. But, in order to avoid applying trust law's strict liability for unauthorized unintentional acts to the directors, the court then proceeded to hold that those directors were not trustees. n35

The inappropriateness of such analogies is illustrated by the courts' treatment of the removal of corporate directors from office, a treatment that essentially blends trust and agency rules and applies the concoction to corporate directors.

Under trust law, a beneficiary cannot remove the trustee without proving in court that the trustee is incapacitated or has a substantial conflict of interest. n36 Each party in an agency relation, however, may terminate the relation at will, even if the result is a breach of contractual obligations. n37 These rules fit the purpose and structure of each relation. A trustee is chosen by the trustor, and must be able to manage the trust assets independently of the beneficiary's control. In contrast, an agent is chosen by the principal, and is subject to the principal's control.

Corporate directors do not fall squarely into the category of their trustee or agent. Just as trustees are free from the interference of beneficiaries, corporate directors should be able to manage without the frequent interference of shareholders. But directors are elected by the shareholders, just as principals choose their agents. Therefore, the shareholders should be able to terminate the directors' tenure in the appropriate circumstances.

Consequently, the courts designed a process to permit shareholders to remove directors that applies a combination of trust removal procedures and agency rules. n38 A director's removal superficially resembles that of a trustee because both contain elements present in a judicial proceeding; a director must be given notice of the charges against him and must have an opportunity to be heard. n39 The power to terminate the relation, however, is vested not in the courts but in the shareholders, the "principals" under the agency model. The courts further adjusted the rules by providing a "mixed" standard for removal that was neither the trust law standard of incapacity or conflict, nor the agency law standard of arbitrary termination. Instead, corporate directors can be removed by the shareholders only for cause, but the standard of cause -- some wrong or injury to the corporation that need not amount to a legal wrong or an incapacity to act n40 -- is less strict than that applied to trustees.

This removal process is cumbersome and inappropriate. The trust model for termination is flawed because the shareholders of a publicly held corporation are not a suitable functional equivalent to a judicial tribunal. n41 Consequently, a number of legislatures authorized removal of directors by a majority of shareholders without cause. n42 But this agency model for termination is also flawed, because allowing the majority of shareholders to remove the directors at will can needlessly disrupt the centralized management services that directors are supposed to provide. Thus, in publicly held corporations, this procedure is rarely used to remove a director during his term, with or without cause. Instead, directors are usually terminated informally (consent), through a takeover (a market mechanism), or in the election process (by a proxy fight).

Courts have also used analogies based on functional similarities between various fiduciary relations. For example, both agents and union officials "represent" another party, principals and employees respectively. Thus, an analogy to this function has led at least one commentator to apply agency law to union officials. n43.

This approach by functional similarity, however, may be inappropriate when the function itself is irrelevant to the problems posed by the specific relation. Courts should focus on a fiduciary's functions only in those cases where the functions bear on the problems posed by the relation. Courts should focus on a fiduciary's functions only in those cases where the functions bear on the problem posed by fiduciary relations. As will be shown later, the problem posed by fiduciary relations is fiduciary abuse of power n44; analogies based on the fact that union officials, like agents, act as representatives do not address this problem. n45 Therefore, the extent of judicial intervention in the union official-employee relationship should depend on the extent to which union members are able to prevent the abuse of power by controlling their officials.

These examples illustrate how mechanical analogies to the features of prototypical fiduciary relations result in rules that are confusing and inappropriate. A more useful approach to fashioning fiduciary law would begin with the general reason for legal intervention in fiduciary relations, namely, the nature and severity of the problem that the law is designed to solve. This Article shows that all fiduciary relations give rise to the problem of abuse of power, that the purpose of fiduciary law should be to solve this problem, and that the differences in the rules applicable to various fiduciary relations stem from differences in the extent of the problem. The analysis will identify the benefits that flow from fiduciary relations, and will develop a method to maximize the benefits and minimize the harm to both parties in a fiduciary relation. The purpose of this analysis is to develop a unified approach to the law governing fiduciary relations.

II

THE INHERENT RISK OF FIDUCIARY RELATIONS

This Part analyzes the nature of fiduciary relations and identifies two characteristic elements of all fiduciary relations. It demonstrates that these elements give rise to a risk that the fiduciary will misuse the power entrusted to him to the detriment of the entrustor. It argues that this risk is inherent in all fiduciary relations. It further shows that the protective mechanisms outside of fiduciary law cannot adequately eliminate this risk to the entrustor. The Part

concludes that the risk of abuse which all fiduciary relations pose for the entrustors is the main feature which triggers the application of fiduciary law, when the protective mechanisms outside of fiduciary law cannot adequately eliminate this risk.

A. An Anatomy of Fiduciary Relations

1. The Substitution Role of the Fiduciary

A central feature of fiduciary relations is that the fiduciary serves as a substitute for the entrustor. The purposes for this substitution vary: A may desire B to act for him in matters in which B is more expert; A may wish to be relieved from performing the activities personally; or he may not want to give up the time or make the commitment that the activity requires.

Not all service relations are automatically fiduciary, however. Some may be classified as contractual, such as electricians' and repairmen's services. Others may fall into a status category, as when a parent substitutes for a child who is unable to take care of himself. Therefore, the substitution feature alone does not distinguish fiduciary from other relations. What is emphasized here is that one characteristic element of the fiduciary relation is the understanding of the parties and the perception by the courts that the fiduciary acts as a substitute for the entrustor, to benefit the entrustor.

n46

2. The Delegation of Power to the Fiduciary

The second central feature of the fiduciary relation is that the fiduciary obtains power n47 from the entrustor or from a third party for the sole purpose of enabling the fiduciary to act effectively. The power that the fiduciary obtains is originally vested in someone else, and is delegated to the fiduciary not for his own use, but solely for the purpose of facilitating the performance of his functions. The fiduciary may be entrusted with a wide variety of delegated powers, depending upon the entrustor's needs. n48 For example, the client may transfer possession of his securities to the broker, and appoint the broker a nominal holder, in order to save the costs and inconvenience of providing the securities in each transaction. The client may also give the broker investment management discretion in order to take advantage of the broker's expertise. n49

B. Fiduciary Relations and the Dangers to the Entrustor

1. Abuse of Power: The Central Problem

The two central characteristics of fiduciary relations -- the substitution function and the delegation of power -- pose a basic problem: while the fiduciary must be entrusted with the power in order to perform his function, his possession of the power creates a risk that he will misuse it and injure the entrustor. The fiduciary cannot effectively benefit the entrustor without a delegation of power, but at the same time, it is difficult or impossible to eliminate the fiduciary's ability to use the power for another purpose to the detriment of the entrustor. Yet if the entrustor lessens his exposure to loss by reducing the delegated power, he may also reduce the benefit expected from the relation. For example, an investor who gives his broker investment discretion benefits from the broker's expertise and diligent observation of the market, but also becomes vulnerable to self-dealing or neglect. If the investor makes the investment decisions himself, he is no longer exposed to abuse of power, but he also loses the benefit of the broker's services and expertise.

It is important to emphasize that the entrustor's vulnerability to abuse of power does not result from an initial inequality of bargaining power between the entrustor and the fiduciary. In no sense are fiduciary relations and the risks they create for the entrustor similar to adhesion contracts or unfair bargains. The relation may expose the entrustor to risk even if he is sophisticated, informed, and able to bargain effectively. Rather, the entrustor's vulnerability stems from the *structure* and *nature* of the fiduciary relation. The delegated power that enables the fiduciary to benefit the entrustor also enables him to injure the entrustor, because the purpose for which the fiduciary is allowed to use his delegated power is narrower than the purposes for which he is capable of using that power.

Fiduciary relations vary by the extent to which each type of fiduciary can abuse his power to the detriment of the entrustor. The magnitude of the risk of abuse depends on: (1) the purpose for which the parties established the relation, and consequently the nature of power that must be delegated to achieve the parties' purposes; (2) the extent of the powers delegated to the fiduciary; and (3) the availability of protective mechanisms that reduce the probability of abuse.

The role of these factors in determining the risk of abuse can be demonstrated by a comparison of different types of fiduciary relations. For example, one of the main purposes for establishing a public corporation is to provide for centralized management. Consequently, the directors of the corporation should have freedom to make timely decisions

without resorting to shareholder approval. On the other hand, employees are usually expected to act only under the employer's control. Therefore, the entrustor-shareholder in a fiduciary relation with a corporate director is much more vulnerable to abuse of power than is the entrustor-employer in his relation with the employee.

Risk of abuse of power may vary even within the context of a single type of fiduciary relation. For example, an agent may need much more freedom in exercising his powers in the principal's absence than in his presence. This example shows again that a mere comparison of prototypes is less helpful in discovering the potential abuse of fiduciary power than is an analysis of the types of powers the fiduciary needs to perform his functions effectively, and the entrustor's vulnerability to abuse of those powers.

2. Alternative Controls and Their Limitations

If the entrustor can protect himself from abuse of power, there is no need for the intervention of fiduciary law. If effective protection is not available, however, it becomes necessary to prevent abuse of fiduciary power and to protect the entrustor. Therefore, the need for fiduciary law depends on the extent to which the entrustor can prevent the abuse of power through other legal or social means.

This Section examines five broad categories of alternative protections: (1) using only fiduciaries who have no conflict of interest with the entrustor; (2) inducing fiduciaries to refrain from abuse of power by rewards; (3) imposing controls upon fiduciaries; (4) monitoring fiduciaries; and (5) using nonjudicial regulation of fiduciaries, such as self-regulation by professional societies and regulation by administrative agencies.

a. Preventing Conflicts of Interest

An ideal fiduciary is one whose interests do not conflict with those of the entrustor. A delegation of power to such a person would create little risk of detriment to the entrustor. However, finding this person is not a realistic possibility. But finding persons with varying degrees of shared interests is sometimes possible. When the fiduciary's interests coincide with those of the entrustor, the entrustor is partially protected because as the fiduciary acts in his own interest he will automatically act in the interest of the entrustor.

For example, conflicts of interest are not as likely when the fiduciary is a family member or friend. But in a predominantly mobile society, such fiduciaries have largely been replaced by commercial fiduciaries. Since it is less likely for a commercial fiduciary to share interests with the entrustor, the commercial fiduciary poses higher risks to entrustors than a friend or family member.

The entrustor may minimize conflicts of interest between himself and the fiduciary by establishing a joint ownership with the fiduciary. The fiduciary by establishing a joint ownership with the fiduciary. The fiduciary may have an incentive to abuse his power, however, if the loss from the joint enterprise is smaller than his gain from abuse of his power. Furthermore, the nature of some fiduciary relations, such as that of attorney and client, is not conducive to a joint venture or joint ownership. Consequently, this arrangement does not protect the entrustor fully from the fiduciary's abuse of power.

b. Providing the Fiduciary with Incentives

An entrustor may reward a fiduciary with fees as incentives for optimal performance. The fiduciary's fee may be tied directly to given results, as when a client pays a lawyer only on winning a case. Similarly, the fee may be tied to the degree of success achieved by the fiduciary, such as when a money manager's fees are measured as a percentage of profits made or expenses saved. ⁿ⁵⁰ This technique may help eliminate or reduce the entrustor's injury from conflicts of interest because he will compensate his fiduciary only if he receives the benefit for which he bargained. ⁿ⁵¹

Often, however, such a fee structure shifts to the fiduciary not only the risk of his own abuse of power, but also the risk of events beyond his control. For example, a physician's fee may be determined by whether a patient lives or dies in treatment. If a performance-based fee shifts the risk of events beyond his control to the fiduciary, he may decline to take the risk, or may demand additional compensation.

Performance-based fees may also produce undesirable incentives. When the fiduciary's fees are measured as a percentage of the entrustor's gains without regard to his losses, the fiduciary may make riskier investments to increase his fee. ⁿ⁵² Moreover, as long as the benefits from abuse can be hidden, performance fees do not create an incentive for the fiduciary not to profit from the relation or otherwise misuse his delegated power. Therefore, fee structures provide only a partial solution to the problem of abuse of power, and raise other problems as well.

c. Controlling the Fiduciary

i. Termination. If the entrustor has the power to terminate the fiduciary relation, the fiduciary may be deterred from abusing his power. Additionally, a fiduciary competing in the market for employment may wish to please his entrustor in order to enhance his reputation, to obtain more business, or to advance in the employee ranks.

Termination is a two-edged sword, however, as it may ultimately work to the detriment of the entrustor. Terminating a trustee, for instance, may leave the beneficiaries helpless as the assets remain unattended. n53 Furthermore, the power to terminate is an ineffective safeguard unless the entrustor can discover the abuse of power and the fiduciary knows he is subject to scrutiny.

ii. Contract. Another possible means of controlling a fiduciary is by contract. The entrustor may attempt to specify in a contract the permissible and impermissible uses of fiduciary power, and the consequences of each violation of the contract. For example, an escrow relation is usually based on a detailed contract made prior to the commencement of the relation. n54

There are two deficiencies to controlling the fiduciary by contract. First, fiduciary relations are not necessarily contractual. n55 The beneficiaries of a trust, for example, are usually not parties to the trust agreement. Similarly, shareholders of publicly held corporations do not have an opportunity to negotiate the terms of the corporation's charter, by-laws, or management employment contracts.

Second, even if such contractual arrangements were feasible, the transaction costs involved in drawing up a detailed prior agreement covering all possible discretionary uses of power over the life of the relation would not only be enormous, but also would probably exceed the benefits of the proposed relation. A more general document (whether a contract, trust, or charter) setting forth only the main purposes of the relation and the broad functions of the fiduciary would not impose such great transaction costs, but would less adequately prevent specific abuses of power. n56

iii. Direct Control. The entrustor may seek to reduce the dangers from the fiduciary relation by exerting direct personal control over the fiduciary's use of power. An agency relation, for example, involves such control. But for some entrustors, such as trust beneficiaries who are minors, direct control over the fiduciary may be impossible. Furthermore, direct control by the entrustor may be inefficient or unrealistic. For example, if the services of the fiduciary are valuable because of their expert nature, the entrustor's control might destroy the benefits gained from that expertise. If the entrustor were himself an expert and could monitor the fiduciary's actions, the entrustor would not have sought a fiduciary in the first place.

In addition, it would be impossible to control the fiduciary if the relation involved a large number of entrustors. Shareholders of a publicly held corporation, for example, are simply unable to direct the corporation's management. The frequently changing body of shareholders lacks both the expertise and the continuity necessary for the constant supervision of the centralized management of a corporation.

Finally, direct control may undermine the very purpose of the fiduciary relation. This result would occur when the relation is designed to exclude the interested parties from control in order to ensure that power is used only for a particular predetermined purpose. The usefulness of a voting trust, for instance, stems from the entrustors' inability to exert control over the voting trustee. Similarly, union members are not permitted to negotiate with the employer individually because it is assumed that workers will gain more concessions when they engage in bargaining collectively through their union.

iv. Indirect Control. Indirect control by the entrustor may include standardization and specification of the objectives the fiduciary must achieve, the procedures he must follow in performing his functions, the operational steps he must take, and the skills he must possess and employ in his activities as fiduciary. This technique helps curb potential abuses of power because it restricts the fiduciary's discretion and provides a method for selecting an appropriate fiduciary. However, like direct controls this technique may undermine the usefulness of the fiduciary relation.

d. Monitoring the Fiduciary

The entrustor may monitor the fiduciary by requiring him to report his activities. However, monitoring does not prevent the fiduciary either from shirking his responsibility or converting his delegated power. It merely facilitates the policing of the fiduciary. Furthermore, monitoring may be costly if the fiduciary hides his activities. Finally, some

entrustors, such as principals, may be in a position to require their fiduciaries to report, whereas others, such as trust beneficiaries, may not have this type of supervisory power.

A competitive market for fiduciary services can help the entrustor monitor the fiduciary. First, it may provide the entrustor with information about particular fiduciaries. Second, a market itself sometimes monitors the fiduciary's performance for the entrustor after the fiduciary relation has commenced. For example, if corporate directors perform poorly, the value of the corporation's stock will decline. n57 Third, a market for the goods in which the fiduciary deals may assist in monitoring the fiduciary. If an investment adviser purchases marketable securities, for example, the market price may indicate whether the adviser abused his power by overpaying.

Many fiduciary services, however, are not offered through competitive markets. Indeed, some fiduciary occupations such as medicine and law have been fully sheltered from competitive markets until quite recently. n58 Furthermore, many fiduciary services are unique, individualized, and hence difficult to compare, making it hard to establish an efficient market for them. Finally, a market for fiduciary services reduces the moral stature and the public service image of professional fiduciaries. n59 Thus, even though markets may help reduce the risks from fiduciary abuse of power, they rarely provide fully satisfactory protection to the entrustor.

e. Other Nonjudicial Regulation

The entrustor may be protected by nonjudicial regulators such as government agencies. Such protection may be adequate if the regulators are experts and the regulation is pervasive. Other nonjudicial regulators are self-regulating organizations of fiduciaries, such as professional societies and families. n60 These organizations are especially effective if they have numerous members, a tradition of acceptable behavior, and enforcement mechanisms.

Self-regulation may be impossible in some cases, as with respect to a husband managing the couple's community property. If self-regulation is feasible, its coercive powers may vary. An organization based on informal self-regulation may be able to exert pressure on its members to conform to its standards, but it cannot enforce its rules in court.

To be effective, a self-regulating body must have the power to coerce or entice fiduciaries to join and abide by its rules. For example, certain kinds of fiduciaries such as attorneys and physicians are prohibited from practicing their profession unless they join the profession's organization. The organization must possess a measure of monopoly over the availability of fiduciary services, but this monopoly raises the problems that all monopolies raise. Moreover, such an organization breeds conflicts of interest. Its members may be interested in minimizing the burdens of self-regulation and maximizing the benefits of the organization's monopoly. Consequently, even though some self-regulating organizations offer a substantial measure of protection for entrustors, such organizations are not a complete solution to fiduciary abuse of power.

D. Summary

Fiduciary relations present a problem because a fiduciary holds a delegated power that is susceptible to abuse. The parties, the market, or others may reduce the potential for abuse of fiduciary power, but not eliminate it. The mechanisms for preventing the abuse are either costly or substantially reduce the entrustor's expected benefit from the relation. Because the entrustor cannot satisfactorily protect himself while maintaining the benefits of the fiduciary relation, the law must intervene to protect him from abuse of power by rules that are sensitive to the dangers that the relations pose for the entrustor. The next Part discusses these rules.

III

JUDICIAL REGULATION OF FIDUCIARIES

The previous Part identified the potential for abuse of power that exists in every fiduciary relation, and showed that alternatives to fiduciary law may be inadequate to protect the entrustor against the abuse. If the entrustor is not protected and risks serious losses from a fiduciary relation, he would refrain from entering into such a relation. As discussed in Part I, fiduciary relations benefit both entrustors and society. n61 The law should therefore protect the entrustor by regulating the fiduciary to promote the relations. n62

This Part discusses some characteristics of the legal regulation of fiduciaries. It shows that the best method to determine when and how courts should regulate fiduciaries is by discovering the problem inherent in all fiduciary relations and providing an appropriate solution for it.

A. Nature of the Regulation

1. Focusing on the Delegated Power

Fiduciary power can arise in a variety of legal contexts. n63 Examples include agency (which may arise in contract transactions), the exercise of the functions of an office (which arises in corporations or unions, among others), individual trusts (which may arise in marriage in community property states) n64 or government trusts (arising from a treaty with Native Americans). n65

Fiduciary law does *not*, however, deal with these contexts, but rather with the problem of abuse of power arising in them. The laws applicable to the situations in which fiduciary power is delegated should not be confused with the principles of fiduciary law. The *same* fiduciary principles apply to fiduciary power, and are superimposed on the *different* bodies of law governing the contexts in which that power appears.

For example, although fiduciary and contract relations may overlap, fiduciary relations can arise in the absence of contract. Thus, in *Harrop v. Cole*, n66 an employee bought land for himself (with his own money) that he was asked to purchase for his employer. Because their agreement had been oral, the employer was precluded from proving its existence by the Statute of Frauds. He successfully asserted his claim for an accounting, however, on the ground that an agency relation existed between him and his employee. The court not only rejected the employee's argument that the agency relation depended on the existence of a contract between the parties, but it also disregarded the parties' agreement altogether, holding that when one acts as another's agent, "he necessarily establishes a fiduciary relation between himself and the other person, who stands as his principal." n67 The court further noted that "[t]he agency may be established by a written contract, or a verbal contract, or no contract, whatever" n68

Similarly, the fiduciary principles regulating directors, officers, and shareholders are independent of corporate law. In *Roland International Corp. v. Najjar*, n69 a ninety percent controlling shareholder used a statutorily authorized short-form merger to force out the minority shareholders. The minority shareholders successfully claimed that because the sole purpose of the merger was to squeeze them out, the majority shareholders violated their fiduciary duties to the minority. The court held that the majority's compliance with all the statutory conditions did not affect its fiduciary duty. The court reasoned that the duty did not arise from the statute, but from "long-standing principles of equity [which are] superimposed on many sections of the Corporation Law." n70

Thus, in designing the law regulating fiduciaries, the courts should separate the problem of abuse of fiduciary power from other problems raised by the legal contexts in which the power arises. The courts should analyze the delegated powers necessary to accomplish the purpose of the relation on which the parties agreed, the potential for abuse of these powers, and the alternative protections available to the entrustor. If they conclude that the entrustor needs protection, they should proceed to regulate the fiduciary.

2. How Courts Regulate Fiduciaries

Fiduciary relations do not give rise to reciprocal legal obligations. With a few exceptions, which, as will be shown, prove the rule, fiduciary law focuses on the fiduciary in the exercise of his delegated power, because only he is vested with power that can be abused. In contrast to contract and status law, a salient feature of fiduciary law is that it regulates only one of the parties -- the fiduciary. n71

Even when the law imposes duties on the entrustor to the fiduciary, these duties are not designed to benefit him, but rather to facilitate the performance of his services by giving him an incentive to act diligently. n72 For example, the entrustor's duty to reimburse the fiduciary for his expenses encourages the fiduciary to spend his own money promptly when it is necessary to protect the interests of the entrustor. n73 Thus, the focus of the law remains on the fiduciary's performance of his services to the entrustor.

An example of the law's focus on regulating only the fiduciary is the principle that the fiduciary is not entitled by the common law to compensation or other benefits by virtue of the fiduciary relation. n74 This principle does not, of course, prevent the fiduciary from obtaining rewards for his services by contracting at arm's length for his fees, n75 by seeking a judicial determination of the value of his services under theories of unjust enrichment or implied contract, or through legislation. n76 However, the fiduciary's recourse is to contract or statute, not to fiduciary law.

This principle strengthens the position of the entrustor and prevents self-dealing by the fiduciary. It also emphasizes the substitution feature of the fiduciary relation, perhaps reflecting the situations in which gratuitous promises among friends and family members are compensated in kind. Fiduciary law attempts to revitalize these circumstances, notwithstanding the commercialization of many of these relations today. Finally, the principle reflects the main concern of fiduciary law, which is that the relation offers the fiduciary opportunities to abuse his power.

3. *When Courts Regulate Fiduciaries*

Unlike status relations, fiduciary relations are not mandated by law. The fiduciary is free to enter or refrain from entering the relation, and cannot be forced to serve without his consent. n77 While the entrustor cannot be *forced* to enter into the relation, he is not always required to *consent* to the relation, because he is the beneficiary of the law's protection. Thus, the law is merely permissive with respect to the parties' decision to enter into the relation.

Once a relation is established, however, its classification as fiduciary n78 and its legal consequences are primarily determined by the law n79 rather than the parties. n80 Thus, unlike a party to a contract, a person may find himself in a fiduciary relation without ever having intended to assume fiduciary obligations. The courts will look to whether the arrangement formed by the parties meets the criteria for classification as fiduciary, not whether the parties intended the legal consequences of such a relation. n81 If the criteria are satisfied, the fiduciary will be subject to duties flowing from that relation, and the entrustor will be entitled to the resulting legal protection. If any part of the agreement between the parties is repugnant to the regulation of the fiduciary, the courts will either ignore that part of the agreement, or opt for a nonfiduciary classification such as gift or sale of power. n82

4. *Continuing Judicial Supervision During the Relation*

When a fiduciary relation is deemed to exist, the parties cannot waive the courts' supervision over the fiduciary, n83 they cannot "shake off" judicial intervention. n84 Courts insist on a continuing role in the fiduciary relation, perhaps because they are skeptical that an entrustor's general waiver to unspecified violations of fiduciary duties can be informed and independent. n85

Even when the courts defer to the parties' limitations on judicial intervention in their relations, the courts always examine whether the entrustor's consent was informed and independent, n86 thus reserving a measure of judicial review. n87 For example, although courts have upheld provisions in corporate articles of association making self-dealing by corporate management not void per se, n88 they have never construed these provisions to preclude judicial review of the self-dealing. n89 Explicit contractual waiver provisions do not remove fiduciary relations from the courts' supervision, but may merely affect the extent of judicial review over the fiduciary's use of his power.

For example, a court may defer to a trustor's appointment of a family member as trustee even when the latter has a conflict of interest, because the trustor is probably in a better position to evaluate the wisdom of the appointment. n90 But when a conflict of interest arises in circumstances that the trustor could not have anticipated, or if the appointed trustee in fact abuses his trust, the court's confidence in the trustor's judgment may weaken, and the court might then remove the trustee. n91

Judicial supervision of a fiduciary's conduct differs from the role of the courts in contract and status relations. In contract relations, courts rarely interfere in the private ordering to which the parties have agreed, except that the courts will not enforce agreements they perceive to be unconscionable. n92 Presumably, courts do not see a need for active participation in discrete transactions. Similarly, although the law plans a decisive role in forming status relations, courts usually do not supervise the conduct of the parties, except perhaps to terminate the relation n93 or when grave injustice results from the parties' conduct. The reasons for this judicial passivity may be that these relations involve special protections to the status Dependent, or that the courts are not institutionally suited for such supervision. n94

In contrast, courts will intervene in the fiduciary relation by requiring the fiduciary to act with loyalty and skill, in the entrustor's best interests. n95 In addition to asserting the power to supervise the fiduciary, courts also assert the power to interpret the delegated powers of fiduciaries and the purpose of the delegation. As the amount of delegated power or the length of the relation increases, judicial intervention also increases.

B. *Substantive Fiduciary Rules*

When private ordering or other alternative means do not provide adequate protection from fiduciary abuse of power, the courts should seek to protect the entrustor by regulating the fiduciary. This Section examines five ways by which courts discourage and uncover fiduciary abuse of power.

1. *Preventing Conflicts of Interest*

Because it is costly to find a fiduciary whose interests are identical with those of the entrustor, much of fiduciary law is designed to prevent the fiduciary from using delegated power to further interests other than those of the entrustor. n96 Acknowledging the frailty of human nature, courts fashion preventive rules to deter the fiduciary from abusing his power. n97 First, they prohibit, supervise, or limit self-dealing. n98 Second, courts may remove a disloyal fiduciary

when the structure of the relation is not compatible with his removal by the entrustor. n99 Third, the law *entitles* the entrustor to rely on the fiduciary's trustworthiness. The entrustor is therefore not required to show that he actually relied on the fiduciary, and the fiduciary has the burden of justifying self-dealing transactions. n100 These rules vary with the extent of the entrustor's vulnerability to abuse.

2. *Controlling the Fiduciary*

Fiduciary law creates causes of action for the entrustor against the fiduciary, even if the parties did not contract. The courts can provide protection to the entrustor by imposing on the fiduciary obligations that the parties would have agreed upon if the cost of contracting or the nature of the relation had not precluded them from doing so.

Thus, a trustee has an obligation to the beneficiary to comply with the terms of the trust instrument, even though the beneficiary is not a party to that instrument. If the trustee fails to do so, he will be liable to the beneficiary for any loss of trust assets even if he was not negligent. n101 A corporate director should act in accordance with the charter and purposes of the corporation, but will be liable to the corporation only if he acts knowingly outside of the corporation's powers or fails to exercise due diligence. n102

The extent of the fiduciary duty varies with the degree of potential abuse of power stemming from the relation. Thus, the standard is stricter for trustees than for corporate directors because the beneficiary does not control the trustee and is locked into the relation, whereas shareholders can terminate the directors or sell their shares if they are dissatisfied with the directors' performance. In either case, however, even though the fiduciary's promise to act for a particular purpose does not create a contractual obligation, fiduciary laws fills the void by imposing a legal duty on him to act for that purpose once he chooses to enter into the relation.

The law may also impose controls on the fiduciary by standardizing the method by which he performs his duties or by requiring that he possess or exercise certain skills. n103 This form of control is compatible with the institutional structure of the courts, because the judicial process involves enunciating reasoned rules and general standards.

Control over the fiduciary, whether by direct means or standardized rules, creates a tension between the need to restrict the fiduciary in order to prevent injury to the entrustor, and the need to leave the fiduciary free to act in order to benefit the entrustor. Therefore, there are areas, ill-defined but usually "operational," in which the courts should defer to the fiduciary's unbiased expert judgment. This difference, however, will never completely free the fiduciary from accountability. n104

3. *Monitoring*

The law strengthens the entrustor's ability to monitor the fiduciary. Many rules governing fiduciaries could be taken from a standard textbook on management techniques. These rules are designed to furnish the entrustor with the legal right to information regarding the fiduciary's activities. Fiduciaries must keep books and records, and account for the use of their delegated power. n105

Ostensibly substantive rules may be motivated by hidden concerns regarding accountability and monitoring. For example, in *Dodge v. Ford Motor Co.*, n106 defendant Ford had declared his intention to reduce the future price of Ford cars for the benefit of society. The minority shareholders, the Dodge brothers, objected. The court held that a corporation is not a charitable institution, but is organized to produce profits for its shareholders. The price reduction was an inappropriate corporate act. But in *A.P. Smith Mfg. Co. v. Barlow*, n107 when a minority shareholder objected to a \$15,000 corporate donation to Princeton University, the court held that the gift was valid, and attempted to redefine the corporation's role in society.

I submit that both *Ford* and *Smith* are good law. The "donation" in *Ford* was flawed because it was of an indeterminate amount to an unspecified number of unknown donees. If Ford had been allowed to reduce the price as a gift to society, the courts and the minority shareholders would have lost the ability to control the amount of the donation and its purpose. But the donation in *Smith* was for a specific amount to a known recipient. The minority shareholders, and eventually the courts, could therefore pass judgment on whether the donation was appropriate.

Courts may also strengthen the monitoring process by acting in a role akin to that of a middleman, thus encouraging the markets for fiduciary services. n108 For example, recent Supreme Court decisions have struck down restrictions on advertising of some fiduciary services, n109 and have imposed strict antitrust laws regarding fee fixing. n110 The Supreme Court was clearly dissatisfied with self-regulation of lawyers and physicians, and responded by strengthening the markets for their services and the protections given to entrustors.

4. Creating Strong Remedies Through Shifting Property Rights

By classifying a relation as fiduciary, the law creates strong property rights for the entrustor as against his fiduciary. n111 In fact and in law, the fiduciary is the owner of the power or property (*hereinafter* power) n112 that was delegated to him. An entrustor can seek to enforce the fiduciary's promise to limit the use of his delegated power. But absent a contract, not every promise is legally binding. Moreover, in the case of a trust, even if the beneficiary were deemed a third party beneficiary or an assignee of the fiduciary's promise, the legal remedies available to him would be weak.

By declaring that a person is a fiduciary, the law shifts the beneficial ownership (the entitlement to benefits from the power) to the entrustor and leaves the fiduciary with mere legal title. n113 This shift vests in the entrustor a property right in the power. The entrustor can enforce the prohibition against abuse of power directly against the fiduciary by strong remedies available to an owner of property.

The technique of shifting entitlements is also used by the courts to award property remedies against a wrongdoer who obtained property legally. By declaring the wrongdoer a constructive trustee, the courts can shift the beneficial ownership of the property to the wronged party.

The classification of a person as a fiduciary helps the entrustor to enforce the fiduciary's promises and duties. First, the classification strengthens the constraints on the use of delegated power. If the beneficial ownership does not "belong" to the fiduciary, he can deal with the property only according to the terms of the delegation of power and for the entrustor's benefit. Second, if the ownership of the property "belongs" to the entrustor, he can seek the court's intervention not only when the relation ends, but also at any time during the relation when the fiduciary abuses his power. The courts thus assume the authority to supervise the fiduciary in the use of his delegated power throughout the relation. Third, through the trust technique, the courts shift the entitlements to any type of property from the ostensible legal owner (the fiduciary) to another (the entrustor), without destroying the legality of the original transfer of the property. n114

Finally, the trust technique provides the vehicle for the judicial creation of *in personam* property rights by which one person (the fiduciary) can be excluded from the use of a certain bundle of property rights even though the exclusion does not affect anyone else. These "property rights" are often created in the very proceedings in which they are asserted. For instance, if an agent undertakes to find a suitable house for his principal, but subsequently acquires a house for himself with his own money, the principal may be entitled to claim the house upon payment of the cost. n115 The right to purchase that house becomes the "property" of the principal to the exclusion of the agent, n116 but not to the exclusion of anyone else who may purchase the house. Similarly, the doctrine of corporate opportunity excludes corporate fiduciaries from appropriating business opportunities that the court believes are part of the power delegated to the corporate fiduciaries. But the rule prevents only corporate fiduciaries from appropriating these opportunities; anyone else can take advantage of them. n117

The Supreme Court employed this trust technique in *Snepp v. United States*. n118 The Court characterized a CIA agent (Snepp) as a fiduciary in order to require him to account for the profits he made from disclosing *nonconfidential* information to the public. Any diligent researcher could have obtained the information, and would have had the right to disclose it for profit without any governmental claim of "ownership." The Court, however, created a property right in the information and the profits derived from it. n119 It then shifted the entitlement to the profits, vesting it in the government to the exclusion of Snepp alone. The fiduciary law remedy was necessary to give the government relief even though Snepp had also breached his contract obligations, because the government could not show pecuniary injury from the breach.

5. The Moral Theme in Fiduciary Regulation

Courts regulate fiduciary by imposing a high standard of morality upon them. This moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor form its basic vocabulary. n120

Two aspects of moral behavior are important to understanding the moral dimensions of fiduciary law. First, moral behavior is altruistic. The moral person serves other members of the society and contributes to society generally. He treats his own interests in a way that benefits others, and he prefers the community to the self. Second, moral behavior is voluntary. Thus, the more self-enforcing the altruistic behavior is, the more it is considered moral. Self-enforcement reduces risk and uncertainty in human relations, avoids enforcement costs and the need for a strong enforcement organization, n121 precludes deception, and allays the fear that the actor will succumb to temptation.

The moral theme in fiduciary law contrasts with the role of morality in contract law. It is true that the law of contract has moved away from Holmes's view that a party may break his contract upon payment of damages, n122 and some writers have even stated that there is a moral duty to perform a contract. n123 Nevertheless, contract law does not go beyond the morals of the marketplace. n124 Each party may distinguish his interests from those of the other and act for his own benefit. In the world of contract, self-interest is the norm, and restraint must be imposed by others. In contrast, the altruistic posture of fiduciary law requires that once an individual undertakes to act as a fiduciary, he should act to further the interests of another in preference to his own.

The law does not impose any obligation to act on the fiduciary except to the extent that he has assumed fiduciary power. n125 A person may agree or refuse to serve as a fiduciary out of purely selfish reasons. On this point, fiduciary law is as individualistic as contract. But because the law gives the fiduciary the choice between avoiding conflicts of interest with another or refraining from acting altogether, the law may be viewed as encouraging altruistic and moral behavior. Thus, once a person becomes a fiduciary, the law places him in the role of a moral person and pressures him to behave in a selfless fashion, to think and act for others. In addition, the moral standard is not left to the fiduciary or to custom. The courts do consider the parties' expectations and professional customs; but in the last analysis, it is the courts that determine the standards.

One can offer a number of reasons and justifications for the judicial incorporation of morality into fiduciary law. First, courts may have resorted to this high standard because of the historical jurisdictional authority over fiduciaries in the ecclesiastical and equity courts. n126 Those courts imposed sanctions based on religion and morality, and not merely on force.

Second, the prevention of fiduciary abuse of power can pose serious problems. The moral theme of the law exerts pressure on the fiduciary to fulfill his obligations once he has agreed to enter into the relation. Morality is useful as an adjunct to law, because a sense of moral obligation will help bring about the desired behavior. Furthermore, an appeal to the fiduciary's conscience may in fact present a disguised threat. n127

Third, the emphasis of fiduciary law on morality resulted in elevating the purpose for which the fiduciary's power is granted to a position of priority over other values which may guide the fiduciary. For example, the corporate director's primary duty is to profit for the shareholders; the duty of the attorney is to represent his client's interests; and the duty of the physician is to heal and prolong life. The duties assume a greater moral stature than other, conflicting moral values. n128 For example, the physician's duty to prolong life may take precedence over mitigation of the patient's suffering and his consideration of the family's impoverishment. But because fiduciaries must use the power entrusted to them for only one purpose, to perform services to the entrustor, ascribing the highest moral value to that purpose encourages the fiduciary's voluntary adherence to it. n129 On the other hand, the moral emphasis on the purpose of the relation is not free from difficulties and criticism as is evidenced by the arguments for social responsibility of corporations and the competing claims on attorneys' fidelity to law enforcement, among others.

A fourth reason for viewing the fiduciary as a moral actor and distinguishing him from a selfish, profit-seeking individual is that the entrustor may refrain from entering into fiduciary relations unless he perceives the fiduciary as one who will pursue the entrustor's interests. By characterizing the fiduciary as an altruistic person, the courts emphasize and highlight the substitution aspect of the fiduciary relation, reassuring the entrustor that the fiduciary will act in the entrustor's interest. n130

Fifth, the moral posture of fiduciaries is related to the vulnerability of the entrustor. It is wrong to injure anyone. But it is more reprehensible to injure someone who cannot protect himself, as an entrustor in a fiduciary relation is. Thus, the degree of moral culpability of the fiduciary is positively related to the extent of the entrustor's helplessness.

Finally, the moral feature of fiduciary law forms a bridge between altruism and individualism by focusing on the objectives toward which the fiduciary must aim. These objectives should not be merely the interests of *others*, but also the collective good, in which the fiduciary also has an interest. n131 To the extent that the law induces fiduciaries to work for the collective good, the law helps shape desirable social trends.

IV

A MODEL OF FIDUCIARY LAW

This Article first discussed the importance of fiduciary relations in our society and showed that fiduciary relations raise the problem of abuse of delegated power. It then argued that alternative means to fiduciary law are inadequate to protect the entrustor against injury by such abuse. This Part proposes a model for the legal regulation of the fiduciary

which will be fair to prospective fiduciaries and entrustors and give both incentives to enter into the relation. The model has three interrelated components. The first deals with the extent to which entrustors should be protected to induce them to enter the relation and the limitations on regulating the fiduciaries to avoid deterring them from offering their fiduciary services.

The second component deals with the interrelation between bargain and legal intervention, seeking to reach a fair allocation of the costs of regulation among the parties. This component is related to the first in that, presumably, unless the result is fair to both parties, the relation will be abandoned by either party. The third component points to ways by which the overall costs of the relation can be reduced through legal intervention, in order to encourage and promote the relation.

A. Providing Incentives to the Parties

Since fiduciary relations are important in our society, the law should provide incentives to encourage potential fiduciaries and entrustors to enter into the relation. Prospective entrustors might refrain from these relations if the risks of abuse of power outweigh the expected benefits. Ideally, an entrustor would compensate the fiduciary only for the benefits that the entrustor expects to obtain from the relation. However, even if he were disposed to pay the fiduciary not to abuse his delegated power, the entrustor still could not effectively bargain for protection, as the fiduciary might always covertly abuse the power. Accordingly the law should regulate the fiduciary to ascertain and reduce the potential risks to the entrustor.

However, prospective fiduciaries cannot be forced to serve. n132 They will refrain from serving if the burden of regulation outweighs their potential benefit from the relation. n133 Therefore, to avoid deterring fiduciaries from entering the relation, the burden of regulation should be limited to that which they might agree to bear.

The incentives to the entrustors by legal protection and the limitation on this protection to avoid deterring the fiduciaries depend on the extent to which each party might withdraw from the relation. This withdrawal depends on two tests. One is a subjective test, namely, the parties' dependence on the fiduciary arrangement. The other is an objective test, namely the minimal protection on which a reasonable entrustor would insist and the maximum burden that a reasonable fiduciary might agree to bear. Only the latter objective test should guide the law. Thus, even if a small investor may have no alternative but to entrust his funds to a manager, the law should afford the small investor protection commensurate with the risk to which the relation exposes him and that which would induce a reasonable investor to entrust his money to the manager. Similarly, even if a fiduciary depends on the relation for his livelihood, the burden placed on him should not exceed that which a reasonable fiduciary would agree to bear. Therefore, a pro bono fiduciary should bear a lighter burden of regulation than one that is fully compensated, only if the regulation is sufficient to induce the entrustor to enter the relation.

B. Fairness

Fiduciary law involves several issues of fairness. n134 This Article addresses only the issue of who should in fairness bear the costs of regulating the fiduciary. Arguably the entrustor should pay only for the benefits gained from the relation. Therefore it is argued here that a fair fiduciary law would shift the costs of protecting against abuse of power away from the entrustor to the fiduciary and the courts.

Ideally, fiduciary law would ensure the entrustor the benefits of his bargain, and would eliminate the danger of abuse and the cost of preventing it. Fiduciary law, however, should not impose the costs of prevention on the fiduciary. Such an imposition is within the domain of criminal law. n135 A fiduciary may be able to shift his costs back to an entrustor by bargaining with him, and the entrustor may agree to enter into the relation even if he might have to bear some of its costs. The law is still fair as long as the entrustor and the fiduciary bargain freely over who should absorb the costs. Yet, if this is so, what does the law contribute by shifting the costs of regulation to the fiduciary?

The answer is that without regulation the entrustor cannot effectively bargain for protection from the fiduciary's abuse of power. Because the entrustor is generally unable to supervise the fiduciary, he can calculate neither the risk of abuse of power nor the amount of injury he might suffer. When the law regulates the fiduciary, the entrustor can determine the cost of the risk with greater certainty. At the same time, if the law imposes the cost of regulation on the fiduciary, he can bargain to shift all or some of the costs of the regulation back to the entrustor. Therefore, under the approach proposed in this Article, fiduciary law will protect the entrustor by ascertaining the costs of regulating the fiduciary, and also achieve fairness for both parties by allowing them to bargain freely over the allocation of the costs of regulation.

C. Lowering the Aggregate Cost of the Relation

The law should use cost-shifting to reduce the overall costs of fiduciary relations, adopting the following five principles. First, because society considers fiduciary relations desirable the parties should not bear the entire costs of regulating the fiduciary; the courts should bear some of these costs.

Second, the extent of legal intervention in the relation should fit the nature and purpose of the parties' arrangement. For example, since a trustee must be free of the beneficiary's control, the beneficiary needs legal protection to a greater extent than a principal who, by definition, controls the agent's activities. Both beneficiary and principal may find it costly to discover when their fiduciaries abuse power by secretly profiting from the relation. Therefore, the law should prohibit both trustees and agents from taking secret profits.

The third principle is that the benefits of the relation should be preserved for the entrustor. As discussed above, the entrustor's benefits from fiduciary relations are frequently commensurate with the amount of delegated power vested in the fiduciary. ⁿ¹³⁶ This power, however, is the source of potential injury to the entrustor. Therefore, any expansion of the fiduciary's power increases the potential for injury to the entrustor. This potential for injury may force the entrustor to increase his self-protection, resulting in greater costs and reduced benefits from the relation. Thus, as the potential abuse of fiduciary power increases, so should judicial regulation of the fiduciary. Up to a certain level, the benefits gained from judicial intervention will exceed the costs of judicial supervision. Consequently, as the benefits from the relation increase, so do the fiduciary's power and potential abuse of the power, and so should legal intervention in the relation.

The fourth cost-shifting principle is that the overall costs of the relation should be reduced as much as possible. If the costs of a particular regulatory scheme are lower for a fiduciary than for an entrustor they should be shifted to the fiduciary. For example, the fiduciary should bear the costs of accounting for his activities and gathering the information needed to carry them out, because these matters are generally within his possession or expertise. Cost-shifting that reduces the overall costs of the fiduciary relation is beneficial to both parties. Cost-reduction minimizes the amount the entrustor may have to pay for his protection if he agrees to bear some of those costs in his bargain with the fiduciary. In addition, reducing the cost to the fiduciary increases the likelihood that the fiduciary will enter into the relation.

A fifth cost-shifting principle is that the fiduciary should bear costs that he would have borne voluntarily or that benefit him. For example, commercial fiduciaries ordinarily seek to establish a reputation for honesty and reliability. Since the entrustor's costs of determining the fiduciary's integrity are high, the fiduciary will have either to spend more to establish his reputation or to lower his fees; his reputation as an honest person is as valuable to him as a brand name is to a producer. ⁿ¹³⁷ Judicial regulation that establishes minimum standards of performance and integrity shift these costs to the fiduciary, but it also enables him to charge more, and it eliminates unfair competition by free riders who would not adhere to voluntary standards.

CONCLUSION

As members in our society become increasingly interdependent, fiduciary relations become predominant and fiduciary law increasingly important. To develop the law in a rational fashion the courts should examine fiduciary relations separately from the legal contexts in which they arise and design the rules not by analogies to prototypical relations but by evaluating the fiduciary power and its potential abuse. Fiduciary law should reduce the costs of preventing this abuse, leaving the parties free to allocate the costs between themselves. The law will thus encourage members of society to enter into the relation, seek each other's services, exercise power responsibly, and act for each other's benefit.

FOOTNOTES:

ⁿ¹ For a description of the enactment of the Statute of Uses in 1536, see 1 A. SCOTT, *THE LAW OF TRUSTS* § 1 (3d ed. 1967). The practice of bailment originated in 13th-century French and German law. 2 F. POLLOCK & F. MAITLAND, *THE HISTORY OF ENGLISH LAW* 155 (2d ed. 1898). Blackstone's Commentaries, written in 1766, contains a full description of how bailments operated. 2 W. BLACKSTONE, *COMMENTARIES* 395-96.

n2 See Allen, *Agent and Servant Essentially Identical*, 28 AM. L. REV. 9, 18 n.1 (1894).

n3 In the Anglo-American legal system, business corporations date from at least the 17th century, and their predecessors, as well as charitable corporations, are even older. W. FLETCHER, FLETCHER'S CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1 (rev. perm. ed. 1974). Partnerships appeared in the common law by the late thirteenth century. A. BROMBERG, CRANE & BROMBERG ON PARTNERSHIP 11 (1968).

n4 See, e.g., *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919); *Zahn v. Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir. 1947); *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 108-11, 460 P.2d 464, 471-74, 81 Cal. Rptr. 592, 599-602 (1969); 13 W. FLETCHER, *supra* note 3, § § 5810-5812 (rev. perm. ed. 1980). See also V. Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations* (unpublished manuscript forthcoming in 71 CALIF. L. REV. (1983)) (discussing the need for majority shareholders' duties to the minority shareholders in transactions involving internal reorganizations). Some cases also impose a fiduciary duty on minority shareholders, especially in close corporations. See generally Hetherington, *The Minority's Duty of Loyalty in Close Corporations*, 1972 DUKE L.J. 921.

n5 *Steele v. Louisville & N.R.R. Co.*, 323 U.S. 192 (1944). While the Supreme Court did not use the term "fiduciary" in this case, the duty "to exercise fairly the power conferred upon [the bargaining representative] in behalf of all those for whom it acts, without hostile discrimination against them" is clearly a fiduciary obligation. *Id.* at 202-03. See also *Hines v. Anchor Motor Freight, Inc.*, 424 U.S. 554, 564 (1976) ("The union as the statutory representative of the employees is 'subject always to complete good faith and honesty of purpose in the exercise of its discretion.'") (quoting *Ford Motor Co. v. Huffman*, 345 U.S. 330, 338 (1953)).

n6 See, e.g., *Hammonds v. Aetna Casualty & Sur. Co.*, 237 F. Supp 96, 102 (N.D. Ohio 1965) (physician-patient relation is fiduciary); *Lockett v. Goodill*, 71 Wash. 2d 654, 656, 430 P.2d 589, 591 (1967) (same); *MacDonald v. Clinger*, 84 A.D.2d 482, 487, 446 N.Y.S.2d 801, 805 (1982) (psychiatrists are fiduciaries with respect to confidential information).

n7 See Comment, *The Rights of Children: A Trust Model*, 46 FORDHAM L. REV. 669 (1978).

n8 For example, the principles governing corporate directors are treated as a part of corporate law. See *infra* notes 27-45 and accompanying text.

n9. There appear to be only three books on the subject by scholars in common-law countries. P. FINN, FIDUCIARY OBLIGATIONS (1977); J. SHEPARD, THE LAW OF FIDUCIARIES (1981); E. VINTER, A TREATISE ON THE HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS (3d ed. 1955). In the United States, works discussing fiduciaries tend to focus on particular species. See, e.g., A. SCOTT, *supra* note 1. For more general treatments of the topic, see, for example, J. SLAIN, C. THOMPSON & F. BEIN, AGENCY, PARTNERSHIP AND EMPLOYMENT 3-27 (1980); Hallgring, *The Uniform Trustees' Powers Act and the Basic Principles of Fiduciary Responsibility*, 41 WASH. L. REV. 801, 802-06 (1966); Hoover, *Basic Principles Underlying Duty of Loyalty*, 5 CLEV.-MAR. L. REV. 7 (1956); Scott, *The Restatement of the Law of Trusts*, 31 COLUM. L. REV. 1266 (1931); Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69; Sealy, *Some Principles of Fiduciary Obligation*, 1963 CAMBRIDGE L.J. 119; Shepard, *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51 (1981).

n10 See *infra* notes 22-26 and accompanying text.

n11 I do not hesitate to postulate this. There appears to be no discussion of the possibility that persons can be totally self-sufficient, except in economic literature and *Robinson Crusoe*.

n12 In this Article, the use of the masculine gender is not meant to preclude the applicability of the feminine.

n13 In some status relations (such as parent-child), however, the Power Bearer will refrain from abusing the Dependent because of a unique and deep identity of interest between the two parties.

n14 See, e.g., H. PLOSCOWE, H. FOSTER & D. FREED, FAMILY LAW 10-14, 829 (1972).

n15 E.g., *Santosky v. Kramer*, 455 U.S. 745, 753 (1982); H. CLARK, THE LAW OF DOMESTIC RELATIONS IN THE UNITED STATES 3-11, 58, 275, 428, 458 (1968).

n16 See *Santosky*, 455 U.S. at 753: "The fundamental liberty interest of natural parents in the care, custody, and management of their child does not evaporate simply because they have not been model parents" The Court uses the term "liberty" to describe a type of property right vested in the parents with regard to the upbringing of the child, though not necessarily with regard to the child's affairs or welfare. The Court also notes that until the state proves the parents' unfitness, "the child and his parents share a vital interest in preventing erroneous termination of their natural relationship." *Id.* at 760.

n17. The term "entrustor" has been coined here to refer to the other party in *any* fiduciary relation because there is no general term presently used to describe this party. There are, of course, various names for the other party to particular fiduciary relations, such as principal (agency) and beneficiary (trust). But there is no general term to encompass all such parties.

"Entrustor" appears to be most descriptive because it connotes both aspects of what this Article defines as the unifying features of fiduciary relations. The first feature, the "substitution function," in which the fiduciary performs services as a "stand-in" for the entrustor, is suggested by the root "trust." (Note that most definitions of "fiduciary" include some aspect of trusting. See, e.g., BLACK'S LAW DICTIONARY 563 (5th ed. 1979) ("a person holding . . . a character analogous to that of a trustee, in respect to the trust and confidence involved in it").) The second feature, the "delegation of power," in which the fiduciary is granted the power to perform these functions, is suggested by the entire word "entrust," which means "[t]o confide . . . the execution of (a task) to . . . a person." 3 OXFORD ENGLISH DICTIONARY (pt. 2) 225 (J. Murray ed. 1897). (For a more complete discussion of these two characteristics of fiduciary relations, see *infra* notes 46-49 and accompanying text.) Furthermore, the word "entrust" brings to mind a type of dependence that is characteristic of fiduciary relations. To avoid confusion with the word "trustor," the reader should pronounce "entrustor" with an accent on the second syllable, as most words beginning with the prefix "en-" are pronounced.

The word is not without flaws, however. For instance, the entrustor is not always the one who delegates power to the fiduciary. In the trust relation, the settlor delegates that power. The beneficiary merely obtains rights by law to enforce the will of the settlor against the trustee. I have simply attempted to find a term that is as descriptive as possible without being confusing. If the term is given the technical meaning that I suggest here, namely, the party to whom the fiduciary owes fiduciary duties, these descriptive flaws can be ignored.

n18 See *infra* note 46 and accompanying text.

n19 H. MAINE, ANCIENT LAW 169-70 (1st ed. 1861).

n20 See, e.g., E. HOEBEL, THE LAW OF PRIMITIVE MAN 327-31 (1979).

n21 The term "individuals" here refers mainly to the status group of the family, because as postulated above, *supra* note 11 and accompanying text, individuals cannot satisfy their needs without assistance from others.

n22 See P. SAMUELSON, ECONOMICS 54 (9th ed. 1973).

In modern economic society [specialization and division of labor] is carried to the *nth* degree. No one man makes the smallest fraction of the commodities that he consumes. In medieval times the artisan made one article and exchanged it for many others. Today a worker produces not even a single good; he may make only shoe tongues or . . . simply turn bolt 999 on the Ford assembly line. Such may be his whole life work. In exchange for doing this, he will receive an income adequate to buy goods from all over the world.

Id. (emphasis in original).

n23 See Allen, *supra* note 2, at 23-24.

n24 For example, public offices were once treated as real property, and could be freely alienated. *E.g.*, J. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 242 (1971); 2 W. BLACKSTONE, *supra* note 1, at 36. Offices are now solely fiduciary in nature, and no longer have the attributes of property. See, e.g., *Essex Universal Corp. v. Yates*, 305 F.2d 572, 575 (2d Cir. 1962). On the development of public offices from property to service, see generally 4 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 520 (1937).

n25 In *Clay v. Thomas*, 178 Ky. 199, 209-10, 198 S.W. 762, 767 (1917), the court said that a beneficiary is entitled to the "business acumen" of the trustee, implying that trusts are used in order to take advantage of the specialization of the professional manager. Along the same lines, the court also noted that the trust relationship "presupposes superior business capacity, better judgment, and broader experience in commercial transactions possessed by the trustee, and there would be no occasion for the relationship were these facts not true." *Id.*

n26 For further discussion of this substitution function, see *infra* Section A(1) of Part II.

n27 A. SCOTT, *supra* note 1, § § 2.3-8.

n28 *Id.* § 8.

n29 *Id.*

n30 *Id.* § 1.3.

n31 *Id.* § 1.4.

n32 *See supra* note 3.

n33 W. BLACKSTONE, *supra* note 1, at 422 (expressing the view that master-servant relations were one of the three branches of domestic relations at common law, along with parent-child and husband-wife); Allen, *supra* note 2.

n34 *E.g.*, *Mainhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928) (stockholders and directors in a close corporation owe each other a duty of loyalty as rigorous as that of partners); *Tenison v. Patton*, 95 Tex. 284, 67 S.W. 92 (1902) (director dealing in his personal capacity with a majority of disinterested directors analogized to a trustee dealing with the trust beneficiary); *Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame*, 75 L.J. Ch. (n.s.) 437, 440 (1906) (Collins, M.R.) (directors are agents for some purposes); *id.* at 442 (Cozens-Hardy, L.J.) (directors should not be analogized to agents on given facts, but to managing partners).

n35 *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

n36 2 A. SCOTT, *supra* note 1, § 107.3.

n37 RESTATEMENT (SECOND) OF AGENCY § 118 (1957).

n38 *E.g.*, *Campbell v. Loew's Inc.*, 36 Del. Ch. 563, 572-76, 134 A.2d 852, 857-60 (1957).

n39 *Id.*

n40 *Id.* at 857-58.

n43 *See infra* note 45.

n44 *See infra* Section B of Part II.

n45 Thus, one commentator emphasized the functional similarity between union representatives and agents and concluded that unauthorized acts by union officials should result in liability only when the officials have acted in bad faith, the standard applied to agents. Leslie, *Federal Courts and Union Fiduciaries*, 76 COLUM. L. REV. 1314, 1320 (1976). The Second Circuit, however, had applied the strict liability rule appropriate to trustees, even though a key safeguard (ability to seek prior judicial interpretation of a disputed document) was available to trustees but not to union officials. *Morrissey v. Curran*, 423 F.2d 393 (2d Cir.), *cert. denied*, 399 U.S. 928, and *cert. denied sub nom. Segal v. Morrissey*, 400 U.S. 826 (1970). I believe the Second Circuit reached the correct result, but that neither rationale explains why one standard of liability should apply rather than another; the use of functional analogies simply does not form an appropriate theoretical basis for making decisions.

n46 In contract and status relations, each party acts for his own benefit. *See supra* notes 13-16 and accompanying text.

n47 The term "power" here means an ability to make changes that affect the entrustor. *See* R. HALE, FREEDOM THROUGH LAW 30 (1952) (power as means or capacity to coerce); Samuels, *The Economy as a System of Power and its Legal Bases: The Legal Economics of Robert Lee Hale*, 27 U. MIAMI L. REV. 261, 277 (1973). For the view that agency, partnership, and other associations enjoy the distribution of sovereign power, see Jacobson, *The Private Use of Public Authority: Sovereignty and Associations in the Common Law*, 29 BUFFALO L. REV. 600 (1980). *See also* Seavey, *The Rationale of Agency*, 29 YALE L. J. 859, 860-61 (1920) (preferring concept of power to concept of authority in describing agency relationship).

n48 The delegation of powers creates a fiduciary relation only to the extent that the powers are necessary to the performance of the fiduciary's function. For example, if clerks performing ministerial tasks are given access to confidential information of their employer, fiduciary law should generally not apply. If the employees could perform their tasks without being entrusted with the information, and the employer without undue cost could deny the employees access to the information, then the negligent employer should have no resort to fiduciary law. He would instead have contract and tort law to protect him.

n49 The act manifesting delegation of power may vary with the power delegated. Where the power is least substantial, there will be the smallest need for an informed and explicit delegation of power from the entrustor to the fiduciary.

n50 Performance-based contracts are less expensive when they depend on periodic observation of the fiduciary's performance than when they require continuous monitoring of the performance. *See, e.g.*, Hashimoto & Yu, *Specific Capital, Employment Contracts, and Wage Rigidity*, 11 BELL J. ECON. 536, 537 (1980) (also proposing formulas to maximize the utility of compensation arrangements to both employer and worker); Lewis, *Bonuses and Penalties in Incentive Contracting*, 11 BELL J. ECON. 292, 293 (1980).

n51 On the difficulties of rating the performance of federal government personnel, see Comment, *Performance Ratings -- Who Needs Them???*, 19 AM. U.L. REV. 509 (1970).

n52 2 T. FRANKEL, THE REGULATION OF MONEY MANAGERS 285-86 (1978).

n53 To protect the beneficiaries, under certain circumstances trust law may prohibit the trustee from abandoning the trust until another caretaker is found. 2 A. SCOTT, *supra* note 1 § 106. For a discussion of the Investment Company Act of 1940 § 26(a)(3), 15 U.S.C. § 80a-26(a)(3) (1976), a similar federal provision for unit investment trusts, see 4 T. FRANKEL, *supra* note 52, at 174-75.

n54 W. BURBY, HANDBOOK OF THE LAW OF REAL PROPERTY 300-02 (1965).

n55 *See infra* notes 66-68 and accompanying text.

n56 *Cf.* Brudney & Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 997, 1005 (1981) (ease of communication allows participants in close corporations to formulate their own agreements; but in large

public corporations, where particularized agreements would require vast numbers of channels of communication connecting all participants, such agreements are impractical).

n57 See, e.g., Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 292-94 (1980) (market for managers helps discipline the firm's managers because they can be readily replaced); Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 265-67 (1967) (market checks managers because a badly managed firm's stock will decline in value and takeovers will occur); Wolfson, *A Critique of Corporate Law*, 34 U. MIAMI L. REV. 959 (1980) (accord with Fama and Manne).

n58 See, e.g., *Arizona v. Maricopa County Medical Soc'y*, 102 S. Ct. 2466 (1982) (applying antitrust laws to medical profession); *Goldfrab v. Virginia State Bar*, 421 U.S. 773 (1975) (applying antitrust laws to legal profession).

n59 For a discussion of the importance of the moral aspect of fiduciary law, see *infra* notes 120-31 and accompanying text.

n60 Cf. T. JOHNSON, *PROFESSIONS AND POWER* 44-45 (1972) (footnotes omitted): For example, with the rise of large-scale business houses in Renaissance Italy, the initial means of controlling the operations of a factor or agent in distant markets was to send a family member or to tie him to the family by marriage. In more modern times, the contract, the free market, and even branded goods have all fulfilled similar functions Those occupations which are associated with possible abuses have given rise to a number of institutionalized forms of control, 'professionalism' being one. Professionalism, then, becomes a peculiar type of occupational control rather than an expression of the inherent nature of particular occupations. A profession is not, then, an occupation, but a means of controlling an occupation.

n61 See *supra* notes 22-26 and accompanying text.

n62 It can be argued, however, that the law should refrain from intervening in fiduciary relations. Generally, the law does not regulate ongoing relations. For example, the law establishes status relations by fixing duties of the parties toward each other. Yet only in exceptional cases does status law interfere in a party's performance of his obligations or in the Power Bearer's use of power over the Dependent. See *supra* notes 14-15 and accompanying text. Similarly, in contract relations, the law ensures the parties' independent and free choice of entering into the relation, and does no more than enforce the rules that the parties establish for themselves.

There are at least five reasons for courts to take a similarly inactive role in regulating the fiduciary. First, and active role would conflict with our society's commitment to individualism and self-reliance. Each party in a relation is expected to protect himself by negotiating with the other. Second, supervising fiduciary power is costly because the supervision involves the enforcement of duties to *act* rather than a prohibition on acting. Third, regulating the fiduciary's use of power involves requiring the fiduciary to further other parties' interests rather than his own. Because people generally act to benefit themselves, the enforcement of this duty is costly, as the probability of violations is high. Fourth, although the fiduciary initially obtains delegated power in a legitimate manner, he has an opportunity to convert it to his own use later, making it difficult to discover the conversion. Finally, fiduciary relations tend to involve long-term, ongoing interactions. It is difficult to enforce performance of ongoing duties in courts of law. In short, enforcement of a fiduciary's duty to use the power that is legally entrusted to him solely for the benefit of others can be costly and difficult.

n63 See also Paragraphs 1-2 of the Introduction.

n64 *E.g.*, *Vai. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 56 Cal. 2d 329, 364 P.2d 247, 15 Cal. Rptr. 71 (1961).

n65 *E.g.*, *Three Tribes of Fort Berthold Reservation v. United States*, 390 F.2d 686, 691 (Ct. Cl. 1968).

n66 85 N.J. Eq. 32, 95 A. 378 (Ch. 1915), *aff'd*, 86 N.J. Eq. 250, 98 A. 1085 (1916).

n67 *Id.* at 34, 95 A. at 379. Accord *RESTATEMENT OF RESTITUTION* § 194 comment d (1936). The *The Restatement of Restitution* also states that a fiduciary relation arises even without consideration or a written instrument; "[i]t is sufficient . . . that the one authorizes the other to act for him . . . and the other undertakes to do so." *Id.*

n68 85 N.J. Eq. at 34, 95 A. at 379. Accord *Mahler v. Tieman*, 550 S.W.2d 623, 628 (Mo. Ct. App. 1977). See also 2 A. SCOTT, *supra* note 1, § 169 ("[The trustee's] duty to administer the trust is not a contractual duty and it is immaterial that he receives no consideration for his undertaking to administer the trust.).

n69 407 A.2d 1032 (Del. 1979).

n70 *Id.* at 1036.

Even criminal law has recognized special penalties for fiduciaries. A fiduciary's subsequent conversion of the property with which he is entrusted does not fit the definition of larceny. See, e.g., *Neal v. State*, 55 Fla. 140, 46 So. 845 (1908); *People v. Riggins*, 8 Ill. 2d 78, 132 N.E.2d 519 (1956); *State v. Lawrence*, 13 Ohio Op. 2d 195, 168 N.E.2d 21 (C.P. 1960). It was for this reason that the crime of embezzlement was created. See R. PERKINS, *CRIMINAL LAW* 353-54 (3d ed. 1982).

n71 For a discussion of mutuality of obligation in feudal (status) law, see, for example, 1 T. GRAIG, *THE JUS FEUDALE AND THE BOOK OF THE FEUS* 583 (J. Clyde trans. 1934).

n72 *RESTATEMENT (SECOND) OF AGENCY*, *supra* note 37, § § 432-437 (enumerating various duties of principal to agent); W. SEAVEY, *HANDBOOK OF THE LAW OF AGENCY* § 165 (1964) (duty to provide means of service).

n73 *RESTATEMENT (SECOND) OF AGENCY*, *supra* note 37, § § 438-440. See also *Rosenfeld v. Fairchild Airplane & Engine Corp.*, 309 N.Y. 168, 173, 128 N.E.2d 291, 293 (1955) (directors entitled to reimbursement for expenses of proxy solicitation when proxy fight used to persuade shareholders of soundness of corporate policy).

n74 See, e.g., 3 A. SCOTT, *supra* note 1, § § 242-243; *UNIFORM PARTNERSHIP ACT* § 18(f) (1969) (absent an agreement, partner not entitled to compensation for acting on partnership business); *RESTATEMENT (SECOND) OF AGENCY*, *supra* note 37, § 378 comment c (agent has no right to compensation absent an agreement, although an agreement can be inferred from the circumstances); 5 W. FLETCHER, *supra* note 3, § 2109 (rev. perm. ed. 1976) (directors or trustees of corporations not entitled to compensation, absent provision in charter, by-laws, or board resolution). Cf. *Hamberg v. Barsky*, 355 Pa. 462, 466-67, 50 A.2d 345, 347 (1947) (fiduciary must perform his obligations even when he is not paid).

n75 If the fiduciary bargains with the entrustor *before* the relation is established, the bargain is presumed to be at arm's length. If an agreement for benefit to the fiduciary is made *after* the fiduciary relation is established, however, the likelihood is greater that the entrustor relied on the fiduciary. Fiduciary law protects the entrustor by obligating the fiduciary to disclose all material facts, requiring an intelligent, independent consent from the entrustor, a substantively fair arrangement, or both. If the beneficiary is unable to give such informed consent, courts may review the arrangement. *E.g.*, *DEL. CODE ANN. tit. 8, § 144* (1974). *See Rogers v. Hill*, 289 U.S. 582 (1933) (salary of corporate officers set out in bylaws and approved by shareholders before corporate officers were appointed; thus, bargain presumed to be at arm's length); 3 A. SCOTT, *supra* note 1, § 222.4 (1967). The law may also relegate the review to an independent party or constituency of the institution the fiduciary serves. *See, e.g.*, Investment Company Act of 1940 § § 10(a), 15(c), 15 U.S.C. § § 80a-10(a), -15(c) (1976).

n76 In England, trustees and executors are not entitled to compensation except under a contract or court order. In the United States, all states provide for trustees' compensation by legislation or by court orders. 2 A. SCOTT, *supra* note 1, § 242.

n77 *E.g.*, F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* § 5 (2d ed. 1920) ("The law does not choose partners for people.").

n78 State courts have long asserted the power to define and classify a relation as fiduciary. *See, e.g.*, *W. SEAVEY, supra* note 72, § 3, (citing *United States v. City of San Francisco*, 23 F. Supp. 40 (N.D. Cal. 1938), *rev'd*, 106 F.2d 569 (9th Cir. 1939), *rev'd* 310 U.S. 16 (1940)); *Valley Nat'l Bank v. Milmoie*, 74 Ariz. 290, 248 P.2d 740 (1952); *Schultz v. Bleckwehl*, 135 Neb. 94, 280 N.W. 257 (1938). *See also Broad v. Rockwell Int'l Corp.*, 614 F.2d 418, 431-32 (5th Cir. 1980) (Trust Indenture Act did not itself give rise to trustee fiduciary duties, but also did not preclude the applicability of state law fiduciary obligations), *aff'd in part and rev'd in part on other grounds en banc*, 642 F.2d 929 (5th Cir. 1981), *cert. denied*, 454 U.S. 965 (1982).

n79 State courts have greater authority to create new classifications and legal duties than do federal courts. Whereas state courts are using their common law powers when they develop fiduciary law, federal courts may develop this body of law only by following the dictates of legislation more closely, especially now that the Supreme Court appears to be limiting the creation of federal common law. *See, e.g.*, *UMW Health & Retirement Funds v. Robinson*, 455 U.S. 562, 570-76 (1982) (implicitly questioning judicial creation of fiduciary law in the labor relations field).

n80 *See, e.g.*, *State v. Compton*, 92 Idaho 739, 744, 450 P.2d 79, 84 (1969) (McQuade, J., dissenting) ("Of course, it is hornbook law that when an agency exists it does so irrespective of the label parties may apply to it . . ."); *Highway Truck Drivers & Helpers Local 107 v. Cohen*, 182 F. Supp. 608 (E.D. Pa.) (prohibiting union officials from using union funds to protect themselves against charges of graft even though union membership voted to approve payments), *aff'd*, 284 F.2d 162 (3d Cir. 1960), *cert. denied*, 365 U.S. 833 (1961); *Clay v. Thomas*, 178 Ky. 199, 206, 198 S.W. 762, 765 (1917) (fiduciary duties are based upon "principles" and not upon the parties' understanding).

n81 *E.g.*, *W. SEAVEY, supra* note 72, § 3 ("The legal consequences of an act done by a person are determined by rules of law and not by his intent. . . . If the relation to which the parties agree satisfies the tests for agency, that is what it is."

n82 See, e.g., *Stouse v. First Nat'l Bank*, 245 S.W.2d 914, 919-20 (Ky. Ct. App. 1951) (if trust instrument amended by nontestamentary writings, amendment will be disregarded and trust instrument will be given effect according to testamentary terms); *Morice v. Bishop of Durham*, 32 Eng. Rep. 947 (Ch. 1805) (where testator left remainder in trust "for such objects of benevolence and liberality as the trustee in his own discretion shall most approve," trust classification failed because court could not exercise supervisory power, and remainder passed intestate).

n83 For example, the entrustor may not freely waive the liabilities of the fiduciary based on breach of the fiduciary's obligations. Nonwaiver rules are judicial and statutory. Their extent may depend on the evaluation of the benefits that the entrustor may gain from the fiduciary's self-dealing, and the costs of ensuring that there actually will be benefits. See, e.g., Anderson, *Conflicts of Interest: Efficiency, Fairness, and Corporate Structure*, 25 U.C.L.A. L. REV. 738, 756 (1978).

Trust law usually prohibits the trustee from self-dealing without the consent of the beneficiary. E.g., 2 A. SCOTT, *supra* note 1, § 170. For a statutory example of a prohibition against waiver of fiduciary obligations, see Investment Company Act of 1940 § 17(i), 15 U.S.C. § 80(a)-17(i) (1976); 2 T. FRANKEL, *supra* note 52, at 233.

See also, e.g., Landrum-Griffin Act § 501(a), 29 U.S.C. § 501(a) (1976) (general exculpatory clauses relieving union officials of liability void as against public policy); RESTATEMENT (SECOND) OF AGENCY, *supra* note 37, § 82-104 (ratification); RESTATEMENT (SECOND) OF TRUSTS § 217 (1959) (beneficiary release of trustee); Note, *Directory Trusts and the Exculpatory Clause*, 65 COLUM. L. REV. 138 (1965) (on effect of exculpatory clauses in trusts).

n84 For example, the duty of loyalty is imposed as a duty arising out of the trust relation regardless of the settlor's intent. "Even if the settlor does intend to confer upon [the trustee] power to act in bad faith, the trustee will not be permitted to do so." 3 A. SCOTT, *supra* note 1, § 187.4.

n85 Thus, even though courts usually give effect to a client's informed consent allowing his former attorney to represent and adverse interest, Note, *Attorney's Conflict of Interest: Representation of Interest Adverse to that of Former Client*, 55 B.U.L. REV. 61, 82 (1965), some cases hold that disqualifying such an attorney is in the public interest, and that a private party may not limit the court's power to regulate attorney conduct. E.g., *Emle Indus., Inc. v. Patentex, Inc.*, 478 F.2d 562, 574 (2d Cir. 1973); *Empire Linotype School, Inc. v. United States*, 143 F. Supp. 627, 631 (S.D.N.Y. 1956). Cf. *In re Boone*, 83 F. 944, 954-57 (C.C. Cal. 1897) (It is "grossly improbable" that a client would fully understand a consent releasing his attorney from all of his fiduciary duties.).

n86 E.g., *Rowland v. Kable*, 174 Va. 343, 6 S.E.2d 633 (1940). Rubin suggests that the validity of waivers should be determined in light of the alternative protections that the waiving party would obtain. See Rubin, *Toward a General Theory of Waiver*, 28 U.C.L.A. L. REV. 478, 536-41 (1981). Even though Rubin does not mention fiduciary law, his proposal, as well as his discussion of waivers under criminal law, is appropriate to test entrustors' waivers of their protective rights.

When the court withdraw their supervision pursuant to the entrustor's informed and independent consent, they view the fiduciary relation as having terminated with respect to the particular transaction. See, e.g., *Keighler v. Savage Mfg. Co.*, 12 Md. 383, 418 (1858).

n87 It is arguable that a provision in the trust instrument relieving the trustee from liability even for ordinary negligence is against public policy. It is improper for a professional trustee, who professes to give careful and skillful service, to escape liability through waiver for failure to render such service. A particular standard of care should inhere in the relation and cannot be dispensed by any provision in the trust instrument. See 3 A.

SCOTT,*supra* note 1, § 187.1 ("[P]ublic policy does not permit the creator of a trust to deprive the court of all power of control."). The settlor, however, may modify the duties if the modification is not against public policy. "In the absence of a statute . . . such [waiver] provisions are not regarded as against public policy if they merely relieve the trustee from liability for ordinary negligence." *Id.* § 222.3.

n88 *See, e.g., Everett v. Phillips*, 288 N.Y. 227, 43 N.E.2d 18 (1942) (deferring to the parties despite the court's perception that the self-dealing fiduciary, corporate management, had a conflict of interest; waiver in corporate documents accorded great weight).

n89 *E.g., Marsh, Are Directors Trustees?*, 22 BUS. LAW. 35, 43-48 (1966).

n90 *E.g., Pyle v. Pyle*, 137 A.D. 568, 572, 122 N.Y.S. 256, 259, *aff'd mem.*, 199 N.Y. 538, 92 N.E. 1099 (1910). But even though the courts may concede to the trustor's appointment of a fiduciary who has conflicts of interest with the beneficiary, the trustee is still not excused from abstaining from other conflicts of interest, or from abusing his power. *Estate of Rothko*, 84 Misc. 2d 830, 837-38, 401 N.Y.S.2d 923, 935 (1975), *modified*, 56 A.D.2d 499, 392 N.Y.S.2d 870, *aff'd*, 43 N.Y.2d 305, 372 N.E.2d 291, 410 N.Y.S.2d 449 (1977). Thus, the fact that a trustor knows that the trustee has a conflict of interest is not an excuse for breach of fiduciary duty. If the conflict is serious enough, the trustee must resign.

n91 *E.g., Michoud v. Girod*, 45 U.S. (4 HOW.) 503, 554-55 (1846).

n92 *E.g., U.C.C. § 2-201*, -203 comment 1 (1980).

n93 SCIENTIFIC ANALYSIS CORP. & REGIONAL INST. OF SOCIAL WELFARE RESEARCH, INC., LEGAL STATUS OF ADOLESCENCE 1980 (1981).

n94 H. CLARK, *supra* note 15.

n95 Legal relations represent a broad spectrum in the balance of power among parties. Status, contract, and fiduciary laws respond to differences in this balance. When courts perceive the need for strong incentives and consequent protections for the entrustors, the relation will be classified as fiduciary. If alternative protections are available, or if the relation is not perceived as sufficiently important to society, contract or status law may be considered more suitable. The classification of the legal relation, however, is directly related to its perceived importance and to the need for protecting the parties.

A hypothetical example will illustrate the point. Suppose X gave Y \$ 100 to be paid to Y's daughter, D, on her 18th birthday, and Y promised to do so. If on her 18th birthday, Y declined to pay D, the court's classification of the relation between X, Y, and D would determine the consequences of X's or D's claim and the remedies available to X and D.

A court could choose a number of alternatives other than classifying the relation as fiduciary. First, it could call X's payment to Y a gift, and could say that X merely asked Y to pay D the \$ 100 if he so desired. In such a case, neither X nor D would have a claim. Second, the court could classify Y as a debtor of X or D in a contract relation. In this case, X would have a direct claim against Y, and D might have a claim as a third party beneficiary or assignee of the debt. D might find it difficult, however, to enforce such a contract. Furthermore, Y could use the money as he wished prior to D's 18th birthday, even wasting it or speculating with it, and neither X nor D could force Y to behave prudently (barring a fraudulent conveyance). Third, the court could classify the relation between Y and his daughter D as one of status. Y would then be free to use the money as he wished,

even for his own benefit. He would be accountable neither to D nor to X, because the power over his daughter and her belongings would be vested in him by law.

The court could also classify the relation as fiduciary, declaring Y a trustee for his daughter. If Y were a trustee, X could not sue Y, but D's situation would be entirely different. First, upon reaching maturity, she would be entitled to claim the money from Y. Second, she could seek the court's assistance *at any time* if the money were invested imprudently, or if Y used the money for his own benefit. If Y did use the money for his own benefit, any profit would belong to the beneficial owner, D. Third, D could also ask, under certain circumstances, for the removal of Y and the appointment of another trustee. Clearly, the fiduciary classification offers D the greatest protection.

n96 It should be emphasized that the only conflicts that pose a fiduciary problem are those that may induce the fiduciary to abuse his power.

n97 For a decision citing human frailty as a motivating factor, see *Litwin v. Allen*, 25 N.Y.S.2d 667, 685 (Sup. Ct. 1940).

n98 A trustee may not self-deal with the trust property, except with the informed and independent consent of the beneficiary. *E.g.*, 2 A. SCOTT, *supra* note 1, § 170. In many cases, courts have even denied that they have any *authority* to permit the trustee's self-dealing. *See, e.g., Clay v. Thomas*, 178 Ky. 199, 206, 198 S.W. 762, 765 (1917). They have also stated that they would prohibit self-dealing even if those transactions might have brought actual benefits to the beneficiary. *Aberdeen Ry. Co. v. Blakie*, 1 Macq. H.L. 461, 472 (Scotland 1854), *cited with approval in Pacific Vinegar & Pickle Works v. Smith*, 145 Cal. 352, 365, 78 P. 550, 554 (1904) (en banc). Directors, however, may deal with corporate assets with the informed consent of disinterested directors or shareholders, although the courts may scrutinize the fairness of the deals. *See, e.g., DEL. CODE ANN. tit. 8, § 144(a)* (1974). And even when an agent self-deals with the principal's consent, the law imposes a duty on him to act fairly and disclose to the principal all material information when necessary. RESTATEMENT (SECOND) OF AGENCY, *supra* note 37, § 390.

n99 2 A. SCOTT, *supra* note 1, § 107 (trustee removed if unfit to administer, clearly shown by evidence of dishonesty); *id.* § 187.4 (trustee never permitted to act dishonestly or in bad faith no matter how broad his discretion).

n100 This rule demonstrates one of the main differences between confidential relations, which often arise in contract, and fiduciary relations. The relations do overlap, however, and courts are sometimes unable to distinguish them. Often, fiduciary relations are defined by the term "confidential." *See, e.g., BALLENTINE'S LAW DICTIONARY* 470 (3d ed. 1969) (defining a fiduciary relation as "[o]ften, but perhaps somewhat loosely, considered as the equivalent of a confidential relation," but acknowledging that there is a "technical distinction" between the two). But the similarities between confidential and fiduciary relations obscure the different reasons for the law's intervention in the relations, and the different problems they pose.

Courts interfere in confidential (contract) relations only when one party *in fact* relies on another, thereby losing his independence and freedom from coercion. 1 A. SCOTT, *supra* note 1, § 2.5. As discussed above, parties to contract relations are expected to protect their own interests. *See supra* Section A(1)(b) of Part I. A court will thus interfere in contract relations only when one party actually is unable to look out for himself.

In contrast, fiduciary relations *entitle* the Other Party to rely on the fiduciary, even without proof that he actually trusted and confided in the fiduciary. *See, e.g., Vai v. Bank of Am.*, 56 Cal. 2d 329, 337-38, 15 Cal. Rptr. 71, 76-77, 364 P.2d 247, 252-53 (1961) (even though estranged wife did not repose trust or confidence in husband, husband's control of wife's share of community property created fiduciary relation; because fiduciary relation determined by control over property of another, "[i]t is evident that while [fiduciary and confidential]

relationships may exist simultaneously, they do not necessarily do so."). Trust and confidence alone are not grounds for imposing fiduciary duties on the confidant. *See Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3d Cir. 1979) (even when plaintiff borrower established a close ongoing relation with defendant bank, and bank subsequently used confidential information obtained during loan negotiations to determine whether it should finance a takeover of the corporation, no fiduciary relation found). Confidential and fiduciary relations thus should not be confused. *See* 1 A. SCOTT, *supra* note 1, § 2.5.

n101 2 A. SCOTT, *supra* note 1, § 201.

n102 *E.g., Litwin v. Allen*, 25 N.Y.S.2d at 699.

n103 *See, e.g.,* Employee Retirement Income Security Act of 1974 (ERISA) § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1976) (pension managers must have skills commensurate with their functions). The law requires trustees and agents to possess and use the skill which they purport to have or are paid for, and in any event, they must exercise whatever skills they actually have. RESTATEMENT (SECOND) OF AGENCY, *supra* note 37, § 379 comment c.

n104 An example of this limited deference is the "business judgment rule" applied to corporate fiduciaries.

n105 *See* 2 A. SCOTT, *supra* note 1, § 173 (duty to furnish information); RESTATEMENT (SECOND) OF AGENCY, *supra* note 37, § 381 (same).

n106 204 Mich. 459, 170 N.W. 668 (1919).

n107 13 N.J. 145, 98 A.2d 581, appeal dismissed, 346 U.S. 861 (1953).

n108 A. ALCHIAN & W. ALLEN, EXCHANGE AND PRODUCTION: COMPETITION, COORDINATION, AND CONTROL 440 (2d ed. 1977).

n109 *See, e.g., Bates v. State Bar*, 433 U.S. 350, 363-82 (1977) (violation of first amendment to ban all attorney advertising); *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976) (violation of first amendment to ban advertising of drug prices); *American Medical Ass'n v. FTC*, 638 F.2d 443 (2d Cir. 1980) (requiring AMA to eliminate restraints on advertising by doctors), *aff'd per curiam*, 455 U.S. 676 (1982). These decisions were based at least partly on the perceived need for information by the consumer, and for developing markets, including markets in fiduciary relations.

n110 *See, e.g., Goldfarb v. Virginia State Bar*, 421 U.S. 773, 780-93 (1975) (applying antitrust laws against fee fixing to the legal profession); *Arizona v. Maricopa County Medical Soc'y*, 102 S. Ct. 2464 (1982) (applying antitrust laws to medical doctors).

n111 These remedies can go so far as to create windfall profits that the entrustor could not have gained by himself. *See, e.g., Diamond v. Oreamuno*, 24 N.Y.2d 494, 501-02, 301 N.Y.S.2d 78, 84, 248 N.E.2d 910, 914 (1969); Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1976) (insiders must account to the

corporation for profits realized from insider trading even though the trading may be prohibited to the corporation).

n112 "Power" refers either to the ability to represent and legally bind the entrustor, such as is possessed by an attorney, or to make decisions affecting the entrustor, as is done by an expert. In addition, however, I use the term "power" here as a convenient shorthand to refer also to traditional property rights, which themselves are a power to exclude others from benefiting from or controlling the property. Entrustors always transfer some power to fiduciaries to begin the fiduciary relation, and often transfer traditional property (e.g., trust assets or real property) as well.

Historically, power has sometimes taken the form of real property. For example, until the beginning of the nineteenth century, certain public offices in England still had the features of property. *See supra* note 24.

n113 For early cases which recognized the trustee as owner of legal title only, see, for example, *Haslewood v. Baldwin*, 23 Eng. Rep. 248 (Ch. 1680), *summarized in* 2 LORD NOTTINGHAM'S CHANCERY CASES 693 (D. Yale ed. 1961); *Henley v. [Turner]*, 22 Eng. Rep. 928 (Ch. 1678), *summarized in* 2 LORD NOTTINGHAM'S CHANCERY CASES, *supra*, at 666; *[Fortescue v. Crompton]*, 22 Eng. Rep. 913 (Ch. 1675), *summarized in* 1 LORD NOTTINGHAM'S CHANCERY CASES, *supra*, at 216 (D. Yale ed. 1957). (This material is taken from a paper prepared by Barbara Hanson, Harvard Law School, in 1980.)

n114 Maintaining the fiduciary as nominal owner of the property (power) enables him to deal with the property effectively because he can act as the property owner towards the outside world, preserving certainty as to the identity of the owner. At the same time, the arrangement permits another person to be the "real owner" of the property, enjoying its benefits and bearing the burden of its loss. This arrangement facilitates the dealings in property by fiduciaries who are doing no more than substituting for entrustors.

n115 RESTATEMENT (SECOND) OF AGENCY, *supra* note 37, § 403 comment d.

n116 W. SEAVEY, *supra* note 72, § § 148-149.

n117 3 W. FLETCHER, *supra* note 3, § 861.1 (rev. perm. ed. 1975).

n118 444 U.S. 507 (1980). *See also* Note, *The Fiduciary Duty of Former Government Employees*, 90 YALE L.J. 188 (1980) (a proposal to restrict former government employees' commercial use of confidential information, correctly perceived as being within the realm of fiduciary law).

n119 *But see Phipps v. Boardman*, [1966] 3 W.L.R. 1009, 1070 (Upjohn, L.J.) ("[I]nformation is not property at all. It is normally open to all who have eyes to read and ears to hear. The true test is to determine in what circumstances [i.e., whether confidential] the information has been acquired.").

n120 E.g., *Henley v. Birmingham Trust Nat'l Bank*, 295 Ala. 38, 322 So.2d 688 (1975); *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928) (Cardozo, J.).

n121 That enforcement organization, which must have power if it is to enforce, can itself pose a fiduciary power problem.

n122 O.W. HOLMES, *THE COMMON LAW* 236 (1881) (M. Howe ed. 1963). *See also* G. GILMORE, *THE DEATH OF CONTRACT* 14 (1974).

n123 *E.g.*, C. FRIED, *CONTRACT AS PROMISE* 14-17 (1981).

n124 *Cf. U.C.C. § § 1-203, 2-103(1)(b)* (1977) (merchant's duty of good faith defined in terms of reasonable commercial standards).

n125 *See supra* notes 78-82 and accompanying text.

n126 For example, the "use," which was considered similar to agency, was originally enforced by the ecclesiastical courts in accordance with canon law. *See* Helmholz, *The Early Enforcement of Uses*, 79 *COLUM. L. REV.* 1503 (1979).

n127 *See* Romans, *Moral Suasion as an Instrument of Economic Policy*, 56 *AM. ECON. REV.* 1220 (1966), reprinted in L. FRIEDMAN & S. MACAULAY, *LAW AND THE BEHAVIORAL SCIENCES* 246 (2d ed. 1977).

n128 *See* T. JOHNSON, *supra* note 60, at 13 (professionals perceived as concerned with the welfare of their clients and the common good, and as motivated by altruistic, ethical, and moral values). *But see id.* at 17 (professionals also perceived as self-interested technocrats).

n129 A. GOLDMAN, *THE MORAL FOUNDATIONS OF PROFESSIONAL ETHICS* 4-5 (1980).

n130 For a discussion of the substitution function, *see supra* Section A(1) of Part II.

n131 R. UNGER, *LAW IN MODERN SOCIETY* 128-33 (1976).

n132 *See supra* note 77 and accompanying text.

n133 *E.g.*, *Goodwin v. Agassiz*, 283 *Mass.* 358, 186 *N.E.* 659 (1933). In *Goodwin*, the court declined to impose on directors a fiduciary duty toward the shareholders from whom they purchase their corporations' shares on inside information. The court stated that the burden of a fiduciary duty might deter experienced and able men from serving as directors. Therefore, it only imposed on the directors the marketplace standards of "upright businessman." *But see, e.g.*, *Diamond v. Oreamuno*, 24 *N.Y.2d* 494, 499, 301 *N.Y.S.2d* 78, 82, 248 *N.E.2d* 910, 913 (1969) (distinguishing between corporate officials who assume the same risks and obtain the same benefits as other shareholders, and those who use their power to gain unfair advantage).

n134 Another issue relates to the *extent* to which fiduciaries (e.g., corporate directors) should be allowed to self-deal. I do not address this issue here.

n135 For example, one convicted of a crime cannot shift part of his fine or prison sentence to another individual.

n136 *See supra* Section B(1) of Part II.

n137 *See* T. JOHNSON, *supra* note 60, at 51-61 (discussing the professions' creation of reputation).