Buffalo Law Review

Volume 56 | Number 1 Article 3

4-1-2008

The Fiduciary Obligation as the Adoption of Ends

Arthur B. Laby
Rutgers University School of Law—Camden

The Fiduciary Obligation as the Adoption of Ends

ARTHUR B. LABY†

TABLE OF CONTENTS

---

† Associate Professor, Rutgers University School of Law—Camden. I am grateful to Sharon Byrd, Deborah DeMott, Jay Feinman, Kimberly Ferzan, Tamar Frankel, Philip Harvey, Edward Janger, John Oberdiek, Dennis Patterson, Paul Secunda, and Jerry Vildostegui for comments on an earlier draft. This Article also benefited from suggestions at workshops at Seton Hall University School of Law and the XXIII World Congress of Philosophy of Law and Social Philosophy. Brian Fitzsimons, Matthew Loughran, and Jeremy Thomas provided valuable research assistance.

INTRODUCTION

Scholars of fiduciary duties have divided themselves into two warring camps. Contractualists maintain that fiduciary duties are default terms the parties would have negotiated if they had unlimited resources to devote to bargaining.[1] They claim that fiduciary duties are and

1. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 34 (1991) [hereinafter EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE] ("[T]he fiduciary principle . . . fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance."); Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 215 ("Fiduciary duties are a type of contract term that applies, in the absence of a contrary agreement, where an 'owner' who controls and derives the residual benefit from property delegates open-ended management power over property to a 'manager.'"); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 4 (1990) ("[W]e present a comprehensive response to prominent corporate law commentators who have argued that private ordering of corporate manager duties should be restricted by mandatory rules."); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) [hereinafter Easterbrook & Fischel, *Contract*] (establishing contract theory of fiduciary duties); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 443 (1997) ("[T]he special status of fiduciary duties, as important as it is, should be of a default nature only."); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 657 (1995) (contract theory of fiduciary duty, with duty of loyalty performing a gap-filling role); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1273 (1999) ("'[F]iduciary duties are the mechanism invented by the legal system for filling in the unspecified terms of shareholders' contingent [contracts].'" (quoting Jonathan R. Macey & Geoffrey P. Miller, *Corporate Shareholders: A Contractual Perspective*, 43 U. TORONTO L.J. 401, 407 (1993))).

should be a set of convenient background rules whose substance is trumped by duties expressed in actual contracts. Under this view, courts deciding fiduciary cases adopt the methods of contract—implying terms and judging behavior against those terms. A rival view holds that key fiduciary duties are a set of externally-imposed rules grounded in status—bedrock principles, many of which are generally nonnegotiable.[2]

Lack of consensus about the nature of fiduciary duties has practical consequences. Courts must grapple with whether all fiduciary duties are subject to contracting or whether some are so important that they override the parties' wishes. Can lawyers, trustees, or other fiduciaries, for example, strike a deal with their principals waiving all fiduciary duties? Other cases hinge on the breadth and applicability of waivers designed to eliminate fiduciary rules or limit liability for breach.[3] The recent decision by The Blackstone Group to sell limited partnership interests through an initial public offering raises this question. In its public filing, Blackstone discloses that the general partner, who would normally owe fiduciary duties to the partnership, shall have no duty or obligation—"fiduciary or otherwise"—when given discretion to make decisions.[4] Enforceability of such a provision turns on the scope of

2. *See, e.g.*, Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 926 (2006) (explaining that loyalty is the "distinctive and unifying element of fiduciary relationships"); Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 70 (2005) ("[L]abeling fiduciary duties 'default rules' threatens to strip fiduciary rules of their moral content."); Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 305 (1999) (arguing that fiduciary relationships "arise and function in ways alien to contractualist thought"); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1246 (1995) ("[S]weeping waivers of fiduciary duties that could undermine such a trust model should not be enforced.").

3. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 367 (Del. 2006) ("Such a provision can exculpate directors from monetary liability for a breach of the duty of care, but not for conduct that is not in good faith or a breach of the duty of loyalty."); Worldspan, L.P. v. Sabre Group Holdings, Inc., 5 F. Supp. 2d 1356, 1358, 1360 (N.D. Ga. 1998) (invalidating waiver regarding dual representation in lawsuit filed five years after consent was obtained).

4. The Blackstone Group L.P., Form S-1 Registration Statement Under the Securities Act of 1933, at 46-47 (filed Mar. 22, 2007), *available at* http://www.sec.gov/Archives/edgar/data/1393818/000104746907002068/a2176832zs-1.htm.

fiduciary terms subject to private ordering. Similarly, parties often quarrel over whether a detailed contract contains all material terms or whether extra-contractual duties can or should be imposed.[5] In still other cases, questions arise regarding whether fiduciaries can defend their practices on efficiency grounds even if individual parties are disadvantaged.[6]

No one denies that many fiduciary duties are subject to contract. The ability to vary fiduciary terms depends on idiomatic state law, and some state legislatures, such as Delaware, seek to give parties maximum freedom to renegotiate fiduciary duties.[7] The ability to vary terms depends also on the type of fiduciary relationship at issue. Corporate and partnership law typically provide more opportunities for waiver than other areas, like trust and guardianship.

Even so, not all fiduciary duties are subject to negotiation and waiver. A core fiduciary obligation exists independent of these rights and responsibilities subject to private ordering. Sometimes contractual limitations are explicit, with courts and legislatures drawing a line in the sand where the ability to negotiate fiduciary rules ends and court-imposed rules begin. In other cases, the limitations are hidden and take the form of requirements based on good faith or similar formulations. The point is that even

---

5. *See, e.g.*, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 20 Cal. Rptr. 3d 234, 238-39 (Cal. Ct. App. 2004) (affirming award of over $500 million with regard to non-payment of royalties stemming in part from breach of fiduciary duty notwithstanding detailed contractual terms and litigation of contract claim), *reh'g granted*, 24 Cal. Rptr. 3d 178 (Cal. 2005).

6. *See* Jenny Anderson, *Spitzer Sues UBS Over Its Fee-Based Brokerage Accounts*, N.Y. TIMES, Dec. 13, 2006, at C8.

7. DEL. CODE ANN. tit. 6, § 15-103(f) (2005) ("A partnership agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a partner or other person to a partnership . . . provided, that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing."); *see also* GA. CODE ANN. § 14-9-108(b)(1) (2003) ("The partner's duties and liabilities may be expanded, restricted, or eliminated by provisions in the partnership agreement; provided, however, that no such provision shall eliminate or limit the liability of a partner for intentional misconduct or a knowing violation of law or for any transaction for which the partner received a personal benefit in violation or breach of any provision of the partnership agreement . . . .").

courts or legislatures that follow a strong contractual tradition preserve a fiduciary core that cannot be altered. Even the dyed-in-the-wool contractualists agree that some aspects of the fiduciary duty are immutable.[8]

Any theory of the fiduciary relationship must account for this irreducible core. How can we best describe the fiduciary's primary obligation? Platitudes such as supreme loyalty or heightened good faith need additional content to be helpful, and phrases such as acting "for the benefit" or "in the interest" of another are true for many non-fiduciary relationships as well. In this Article, I seek to demonstrate that the irreducible core of the fiduciary relationship is the fiduciary's obligation to adopt the principal's goals, objectives, or ends. Courts use many formulations to describe this duty but in each case the core duty is the same.

The duty to adopt another's ends derives from Immanuel Kant's moral philosophy and his discussion of duties owed to others. A requirement to adopt another's ends is an example of what Kant calls an imperfect duty, which he contrasts with a perfect duty.[9] Perfect duties are narrow in scope; they are generally duties of omission, such as prohibitions against improper conduct.[10] Imperfect duties are open-ended; they are generalized duties to adopt maxims or policies in furtherance of an objective or end.[11] As I shall demonstrate, viewing the fiduciary duty as a duty to adopt the principal's ends better explains leading fiduciary cases than does the contractual account.

This Article has three Parts. Part I examines the contractual approach, concluding that it is not a comprehensive theory of the fiduciary relationship because it is both over- and under-inclusive. Although a theory

---

8. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1436 (1989) (stating that corporate directors and managers "may not contract out of the 'duty of loyalty'").

9. IMMANUEL KANT, THE METAPHYSICS OF MORALS *390-91 (Mary Gregor trans., Cambridge Univ. Press 1991) (1797) [hereinafter KANT, METAPHYSICS OF MORALS]; IMMANUEL KANT, FOUNDATIONS OF THE METAPHYSICS OF MORALS *421 (Lewis White Beck trans.) [hereinafter KANT, FOUNDATIONS]; *see also* MARY J. GREGOR, LAWS OF FREEDOM 95-112 (1963) (discussing and applying Kant's distinction of perfect and imperfect duties). All page references to Kant's writings are to the Academy Edition's pagination.

10. KANT, FOUNDATIONS, *supra* note 9 at *424-25.

11. *Id.* at *430.

cannot explain every case, a robust theory should explain the leading cases and the main tendencies in most. Leading fiduciary cases, however, do not support the contractual thesis. Part I also demonstrates that certain fiduciary rules are nonnegotiable and concludes that contractualists wrongly dismiss these rules as trivial. Part II provides an alternative explanation of the core fiduciary obligation as a duty to adopt the principal's objectives or ends based on Kant's discussion of imperfect duties found primarily in his *Doctrine of Virtue*, the second part of *The Metaphysics of Morals* of 1797.[12] The fiduciary duty is better viewed as a duty to adopt the principal's ends. Part III applies the work of Parts I and II. It demonstrates that leading cases, including cases contractualists believe support their claim, can better be described by a duty-based approach, not a contractual one. Part III also explains why questions about who is a fiduciary in the common law can best be answered through a deontological lens, not the lens of contract.

I. THE CONTRACTUAL APPROACH

Fiduciary relationships are ubiquitous in the law. Some fiduciary relationships, such as trustee and beneficiary, lawyer and client, and partners in a partnership, arise in the common law.[13] Other fiduciary relationships, such as investment advisor and client, are creatures of statute.[14] The law regarding who is a fiduciary is evolving. Majority shareholders, for example, were first held to be fiduciaries

12. KANT, METAPHYSICS OF MORALS, *supra* note 9 at *373.

13. *See, e.g.*, Ledbetter v. First State Bank & Trust Co., 85 F.3d 1537, 1539 (11th Cir. 1996) (trustees); Barker v. First Nat'l Bank, 20 F. Supp. 185, 186 (N.D. Ala. 1937) (trustees); Venier v. Forbes, 25 N.W.2d 704, 708 (Minn. 1946) (partners); Meyer v. Maus, 626 N.W.2d 281, 286 (N.D. 2001) (attorneys); Stephenson v. LeBoeuf, 16 S.W.3d 829, 836 (Tex. App. 2000) (attorneys); Salhinger v. Salhinger, 105 P. 236, 237 (Wash. 1909) (partners); *see also* John C. Coffee, Jr., *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 AM. CRIM. L. REV. 117, 150 (1981) (stating that common law fiduciary includes executors, guardians, trustees, attorneys, and directors); Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 541 (1949) (stating that fiduciaries include trustees, guardians, agents, attorneys, executors, and partners).

14. SEC v. Capital Gains Res. Bureau, Inc., 375 U.S. 180, 194-95 (1963) (noting that Congress recognized advisors to be fiduciaries in the Investment Advisers Act).

in the early part of the twentieth century.[15] And the advent of some fiduciary relationships depends on the particular facts surrounding the relationship. Physicians are considered fiduciaries in some cases but not others;[16] even spouses can owe fiduciary duties to one another depending on the circumstances.[17]

Courts have differing views with respect to when fiduciary duties arise. Some look to reliance by the principal and dominance or control by the fiduciary as evidence of a fiduciary relationship.[18] Others look to trust and confidence on the part of the principal matched with influence or superiority by the fiduciary.[19] In all cases, a fiduciary owes a duty of loyalty to act loyally in the principal's interest and

---

15. S. Pac. Co. v. Bogert, 250 U.S. 483, 492 (1919) ("It is the fact of control of the common property held and exercised [by majority shareholders], not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation.").

16. *See* Shea v. Esensten, 107 F.3d 625, 626-27 (8th Cir. 1997) (stating HMO must disclose financial incentives affecting patient's decision to accept his physician's advice); Moore v. Regents of the Univ. of Cal., 793 P.2d 479, 483 (Cal. 1990) (stating physician must obtain patient's informed consent and disclose personal interests that may affect medical judgment); *see also* Mary Anne Bobinski, *Autonomy and Privacy: Protecting Patients From Their Physicians*, 55 U. PITT. L. REV. 291, 347-56 (1994) (stating that a physician's fiduciary duty must be determined on a case-by-case basis).

17. United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) ("Although spouses certainly may by their conduct become fiduciaries, the marriage relationship alone does not impose fiduciary status."); Francois v. Francois, 599 F.2d 1286, 1292 (3d Cir. 1979) (stating marital relation does not automatically give rise to fiduciary relationship, rather each relationship must be separately analyzed).

18. *See, e.g.*, Oil & Gas Ventures—First 1958 Fund Ltd. v. Kung, 250 F. Supp. 744, 749 (S.D.N.Y. 1966) (stating fiduciary relationship can be founded on dominance, which is determined on all facts).

19. *See* eToll, Inc. v. Elias/Savion Adver., Inc., 811 A.2d 10, 23 (Pa. Super. Ct. 2002) ("[T]he critical question [in determining the existence of a fiduciary relationship] is whether the relationship goes beyond mere reliance on superior skill, and into a relationship characterized by 'overmastering influence' on one side or 'weakness, dependence, or trust, justifiably reposed' on the other side." (emphasis omitted) (quoting Basile v. H & R Block, Inc., 777 A.2d 95, 101 (Pa. Super. Ct. 2001), *rev'd*, 926 A.2d 493 (2007)); *Chestman*, 947 F.2d at 569 (stating fiduciary relationship is characterized by trust and confidentiality); Barbara A. v. John G., 193 Cal. Rptr. 422, 432 (Cal. Ct. App. 1983) ("The essence of a fiduciary or confidential relationship is that the parties do not deal on equal terms, because the person in whom trust and confidence is reposed and who accepts that trust and confidence is in a superior position to exert unique influence over the dependent party.").

a duty of care to undertake reasonable actions on the principal's behalf.[20] Several scholars of fiduciary law have attempted to construct a unified theory of fiduciary duties,[21] some viewing them as including mandatory duties that cannot be altered by contract,[22] others viewing them as contractual.[23]

The contractual analysis of fiduciary duties is both positive and normative.[24] The positive aspect is that fiduciary duties, as espoused by judges and legislatures, are contractual in nature. Scholars writing in the positive tradition look at the law "as is" and explain how we got here. The normative aspect is advocacy—arguing and explaining to judges, legislatures, and others why they should adopt a contractual model when deciding fiduciary cases or writing fiduciary rules. My emphasis is primarily on the positive aspect and Part I demonstrates that the contractual approach does not adequately explain fiduciary duties as a positive matter and forces one to look elsewhere.

---

20. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. e (2006) ("As a general matter, the term 'fiduciary' signifies that an agent must act loyally in the principal's interest as well as on the principal's behalf."); RESTATEMENT (SECOND) OF TRUSTS § 170 (1959) (stating that under fiduciary duty of loyalty, trustee must act solely in the interest of the beneficiary); RESTATEMENT (SECOND) OF CONTRACTS § 193 cmt. a (1981) ("A fiduciary is expected to refrain from acting for his private advantage or otherwise contrary to the interests of his beneficiary or principal in matters affecting the fiduciary relation . . . .").

21. *See, e.g.*, DeMott, *supra* note 2 (arguing that fiduciary duty exists when one party can justifiably expect loyalty from another); J. C. Shepherd, *Towards A Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51, 75 (1981) ("A fiduciary relationship exists whenever any person receives a power of any type on condition that he also receive with it a duty to utilise [sic] that power in the best interests of another, and the recipient of the power uses that power."); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002) (posing a unified fiduciary duty theory based on whether an actor "acts on behalf of another party . . . while exercising discretion with respect to a critical resource belonging to the beneficiary" (emphasis omitted)).

22. *See supra* note 2.

23. *See supra* note 1.

24. *See* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at vii ("Most of [this book] is an exercise in positive economics—that is, we take the world and its laws as given and try to understand why they are as they are."); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1378 (1993) ("The contractarian view thus rests on a descriptive assessment of current possibilities, as well as a normative vision of the limited role that law should play . . . .").

A. *The Contractual Approach to Fiduciary Duties*

According to the contractual model, fiduciary duties arise from high costs of contract specification and monitoring.[25] For some types of contracts—long-term complex contracts that entail broad discretion—it is costly to specify all possible conditions and the resultant obligations. Instead, contracting parties perform a cost-benefit analysis; if the benefit of negotiating additional terms is not worth the cost, the contract remains silent. Contractualists maintain that in such cases, the fiduciary and principal rely on default rules that can be renegotiated at any time. Duties of loyalty and care are *enabling*, *suppletory*, or *negotiable* rules that the parties would have chosen if they had unlimited resources to bargain.[26] What is important about understanding fiduciary duties is the way they are articulated—as *waiveable* default terms.

The norm underlying the contractual approach is wealth-maximization.[27] If the parties had unlimited

---

25. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 427 ("[A] 'fiduciary' relation is a contractual one characterized by unusually high costs of specification and monitoring."); EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at 90 ("If contracts can be written in enough detail, there is no need for 'fiduciary' duties as well."); Butler & Ribstein, *supra* note 1, at 30 (stating that fiduciary duties are closely related to explicit contract terms because parties cannot specify the entire contract in their promise); Langbein, *supra* note 1, at 657-58 (applying Easterbrook and Fischel's model of fiduciary duties arising from high costs of contract specification and monitoring to trust law).

26. *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 90-91 (1989) (providing taxonomy for contractual approach to fiduciary duties).

27. *See, e.g.*, Easterbrook & Fischel, *Contract*, *supra* note 1, at 426 ("Because the process is contractual—because both principal and agent enter this understanding for gain—the details [of terms such as 'duty of loyalty'] should be those that maximize that gain, which the contracting parties can divide."); *id.* at 446 ("[W]hen transaction costs are too high, courts establish the presumptive rules that maximize the parties' joint welfare."). Wealth maximization is the Kaldor-Hicks concept of efficiency, also called potential Pareto superiority. A reallocation of resources is efficient if the resulting increase in wealth is sufficient to compensate the loser so that, after compensation, he is no worse off than he was before the reallocation. (The compensation need not actually take place.) The other common concept of efficiency is Pareto superiority—one state of affairs is Pareto superior to another if at least one person is made better off and no one is made worse off. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 19 n.2 (2002) (differentiating Pareto superiority and Kaldor-Hicks

resources to bargain, they would agree on contractual terms to maximize their wealth. Thus, if the parties fail to specify terms, it makes sense for courts to impose terms mirroring what the parties would have negotiated had they thought about it. Courts assign rights and responsibilities to the parties who, absent transaction costs, would have acquired them through contract, thereby promoting efficiency.

For support, contractualists point to the fundamental tenet of trust law that a trustee cannot sell trust property to himself, which contractualists maintain is itself an enabling rule.[28] The Restatement of Trusts, for example, provides that an express provision in a trust document trumps the duty of loyalty.[29] Elsewhere, the Restatement says that insofar as the trust terms allow, a trustee can sell trust property to himself individually or, as trustee, he can purchase property from himself individually, or otherwise deal in trust property.[30] The American Law Institute extended this principle in the most recent draft of the Restatement. A comment to new section 78, Duty of Loyalty, provides: "[E]ven the vital fiduciary duty of loyalty is a *default rule* that may be modified by the terms of the trust."[31]

Contractual scholars also point to fiduciary duties in corporate law to support the thesis. A corporation is considered a nexus of contracts between and among shareholders, creditors, suppliers, managers, directors, and others. All parties negotiate their respective positions and the deal struck by shareholders is to provide equity capital in exchange for becoming residual claimants. Non-shareholder parties have fixed claims and are protected through contracting. After the fixed claims have been paid, shareholders are entitled to what remains; they bear the risk of failure but reap the rewards of success and have the strongest interest in the company's profitability. Shareholders, however, are unable to negotiate a detailed contract to require the optimal level of risk-taking.

---

efficiency).

28. Langbein, *supra* note 1, at 636, 659.

29. RESTATEMENT (SECOND) OF TRUSTS § 222 (1959).

30. *Id.* § 170(1) cmt. t.

31. RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (Tentative Draft No. 4, Apr. 5, 2005).

Fiduciary duties, therefore, fill the gap requiring managers and directors to act in the interest of shareholders as opposed to other claimants.[32]

Under the contractual model, corporate fiduciary duties are said to be enabling, not mandatory. Jonathan Macey argues that the primary features of corporate law—limited liability, legal personhood, indefinite life, and free transferability of shares—can be amended by contract.[33] Rules governing corporate opportunities and conflicts of interest are said to be negotiable as well.[34] Some have pointed to the adoption of state statutes permitting corporations to amend their charters and allow directors to opt out of the duty of care.[35] Section 102(b)(7) of the Delaware General Corporation Law, for example, allows a corporation to limit personal liability of directors for breaches of the duty of care.[36] Managers are said to have flexibility in other areas too. If they do not like the law in one state, they can reincorporate in another. If the federal securities laws are too onerous, companies can go private, limiting or eliminating many disclosure obligations. If the very nature of the corporate form is a problem, managers can convert to a partnership or limited liability company.[37]

Viewing fiduciary duties as implied contractual terms suggests there is nothing unique or special about them. Frank Easterbrook and Daniel Fischel state that fiduciary duties just mirror the bargain the parties would have

---

32. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at 68 (explaining that shareholders elect directors, who may act in their interest, because shareholders are the residual claimants of the firm and have the best incentives to make appropriate discretionary decisions).

33. Macey, *supra* note 1, at 1270; *see also* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at 11-12.

34. Macey, *supra* note 1, at 1278-79.

35. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1012 (1997) (stating that section 102(b)(7) "allows Delaware corporations to opt out of director liability for breach of the duty of care"); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 7 (1989) ("[S]ection 102(b)(7) . . . allowed firms to 'opt' out of the strengthened duty of care standard . . . .").

36. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

37. *See* Macey, *supra* note 1, at 1271.

reached had they been able to bargain for free.[38] According to Easterbrook and Fischel, fiduciary rules are socially optimal penalties that enable the parties to capture the benefits obtained by delegating authority to the fiduciary while at the same time constraining the fiduciary from furthering its own interests as opposed to the principal's interests.[39] Fiduciary duties as implied contractual terms, however, should not override express contractual terms.[40]

B. *Limitations of the Contractual Approach*

The contractual account is incomplete. The contractual account is not a robust explanatory model for fiduciary relationships because it is both over- and under-inclusive. It is over-inclusive because certain relationships are characterized by high costs of specification and monitoring, but no fiduciary duties arise. The model is under-inclusive because in many cases, the parties draft a detailed agreement, yet courts find that fiduciary duties arise irrespective of the contract. A good example, discussed below, is *Meinhard v. Salmon*.[41] This section also addresses the contractual claim that mandatory fiduciary terms either do not exist or are trivial. I examine the duties of trustees and corporate officers to demonstrate that such mandatory terms are important and significant.

1. *The Over- and Under-Inclusive Critique.* Contract cannot explain when fiduciary relationships arise. Under the contractual model, fiduciary duties should appear where the parties face high costs of contract specification and monitoring. This claim is over-inclusive, however,

---

38. Easterbrook & Fischel, *Contract*, *supra* note 1, at 427.

39. Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1982).

40. *Id.* at 703 n.15. Easterbrook and Fischel make the statement that fiduciary duties have no moral foundation—they are just like other contractual undertakings. Easterbrook & Fischel, *Contract*, *supra* note 1, at 427. This statement is puzzling because the contractual approach, designed to promote wealth, is justified by a consequentialist moral philosophy. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 16 (6th ed. 2003) (tying Kaldor-Hicks efficiency (wealth maximization) to utilitarianism). The primary rival to consequentialism, deontology, however, supports a rival view of the fiduciary obligation. *See infra* Part II.

41. 164 N.E. 545 (N.Y. 1928).

because many relationships are marked by high costs of contract specification and monitoring, but fiduciary duties are absent. Securities brokerage is an example. Brokerage customers typically sign an account opening agreement where specification of terms is difficult. Most customers are unlikely to understand, let alone specify, the agreement regarding the clearing broker used to execute and clear transactions, custodial services, or calls for additional collateral. Costs of monitoring are similarly high. Brokers historically were paid a commission for each transaction executed but they were criticized for "churning" customer accounts—engaging in excessive trading for the sole purpose of generating commission dollars.[42] Notwithstanding high costs of specification and monitoring, brokers generally are not considered fiduciaries to their customers.[43]

---

42. *See* Mihara v. Dean Witter & Co., 619 F.2d 814, 820 (9th Cir. 1980) (stating that in cases of churning, customer may hold broker liable under Rule 10b-5 under the Securities Exchange Act).

43. Although exceptions exist, in most jurisdictions, absent special circumstances, the stockbroker-customer relationship is not a fiduciary relationship. *See, e.g.*, Indep. Order of Foresters v. Donald, Lufkin & Jenrette, Inc., 157 F.3d 933, 940 (2d Cir. 1998) (stating that under state law, "there is no general fiduciary duty inherent in an ordinary broker/customer relationship"); Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc., 3 F.3d 208, 212 (7th Cir. 1994) ("A broker-dealer in Wisconsin is not a fiduciary with respect to accounts over which the customer has the final say . . . ."); Hotmar v. Lowell H. Listrom & Co., 808 F.2d 1384, 1387 (10th Cir. 1987) (holding that under Kansas law, existence of fiduciary duty depends on the facts); Romano v. Merrill Lynch, Pierce, Fenner & Smith, 834 F.2d 523, 530 (5th Cir. 1987) (stating that the nature of fiduciary duty depends on the facts and that no fiduciary duty exists where the client was sophisticated and controlled the account); Lefkowitz v. Smith Barney, Harris Upham & Co., 804 F.2d 154, 155 (1st Cir. 1986) ("[A] simple stockbroker-customer relationship does not constitute a fiduciary relationship in Massachusetts."); Leboce, S.A. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 709 F.2d 605, 607 (9th Cir. 1983) (imposing, under California law, a fiduciary duty on broker when it, "'for all practical purposes,'" controls the investment account (quoting Twomey v. Mitchum, Jones & Templeton, Inc., 69 Cal. Rptr. 222, 240 (Cal. Ct. App. 1968))); Marchese v. Nelson, 809 F. Supp. 880, 891 n.18 (D. Utah 1993) (stating that under Utah law, a broker over a non-discretionary account is not a fiduciary); Patsos v. First Albany Corp., 741 N.E.2d 841, 850-51 (Mass. 2001) (stating that whether a fiduciary relationship exists between broker and client depends on the lack of investment acumen of the client); McCracken v. Conticommodity Servs., Inc., 755 P.2d 454, 456 (Colo. App. 1988) (stating that a customer must prove the broker has "practical control" of his account to establish a fiduciary relationship (quoting Paine, Webber, Jackson & Curtins, Inc. v. Adams, 718 P.2d 508, 517 (Colo. 1986))). *But see* Marchese v. Shearson Hayden Stone, Inc., 734 F.2d 414, 418 (9th Cir. 1984) ("As a securities broker and commodities

Audit services are another example. A fully specified audit engagement letter could contain hundreds or thousands of detailed terms. Instead, engagement letters typically focus on objectives, responsibility of management, and fees. The shift to principles-based accounting introduces more ambiguity into the relationship.[44] Allocation of risk in the event of misconduct is typically omitted and, when such terms appear, enforceability is uncertain.[45] Monitoring is costly as well. Historically, shareholders faced difficulties monitoring audit firms because of concerns about their independence from company management. Unbeknownst to shareholders, auditors would give a clean bill of health to management in the face of management's implicit threat to terminate non-audit related business performed by another part of the audit firm.[46] Despite high costs of specification and monitoring, an auditor is not a fiduciary to an audit client.[47]

---

futures commission merchant, Shearson stood in a fiduciary relationship with Marchese."); *In re* Scheuer, 125 B.R. 584, 592 (Bankr. C.D. Cal. 1991) (imposing fiduciary duty on stockbrokers under California law).

44. *See* Rebecca Toppe Shortridge & Mark Myring, *Defining Principles-Based Accounting Standards*, CPA JOURNAL, Aug. 2004, at 34, 36 ("Many accountants seem to prefer rules-based standards, possibly because of their concerns about the potential of litigation over their exercise of judgment in the absence of bright-line rules."); Letter of Robert H. Miles, Senior Vice President and Controller, Washington Mutual Bank, to Ms. Suzanne Q. Bielstein, Financial Accounting Standards Board, Jan. 2, 2002, *available at* http://www.fasb.org/ocl/1125-001/14021.pdf (explaining that principles-based accounting would lead to interpretive guidance developed "behind closed doors").

45. Indemnification or limitations on the auditor's liability could impair independence. Eric L. Talley, *Cataclysmic Liability Risk Among Big Four Auditors*, 106 COLUM. L. REV. 1641, 1642 (2006); William D. Sherman, Audit Engagement Letters May Affect Auditor Independence, Morrison & Foerster, Legal Updates & News (Mar. 2006), http://www.mofo.com/news/updates/files/update02163.html.

46. *See, e.g.*, Strengthening the Commission's Requirements Regarding Auditor Independence, Securities Act Release No. 8183, Exchange Act Release No. 47,265, Public Utility Holding Co. Act Release No. 27,642, Investment Co. Act Release No. 25,915, 68 Fed. Reg. 6006 (proposed Feb. 5, 2003), *available at* http://www.sec.gov/rules/final/33-8183.htm; John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 322 (2004) (discussing auditors' failure to stop aggressive accounting policies).

47. *See, e.g.*, VTech Holdings Ltd. v. Pricewaterhouse Coopers LLP, 348 F. Supp. 2d 255, 268 (S.D.N.Y. 2004) ("[T]he accountant-client relationship does not generally give rise to a fiduciary relationship . . . ."); KPMG Peat Marwick v.

The contractual approach is also under-inclusive because it does not account for the many relationships where high costs of specification and monitoring are absent or surmountable, yet fiduciary duties arise. If the contractualists were right, courts would not uphold a fiduciary relationship where parties negotiate detailed agreements.[48] Actual terms, contractualists argue, should trump implied terms every time.[49] Leading cases in agency, partnership, and other areas of fiduciary law, however, hold that one's status as an agent or partner depends not on terms the parties negotiated but rather on the court's objective view of the relationship.[50] Courts uphold fiduciary duties even where the parties negotiate detailed contracts and, in some cases, try to expressly disclaim fiduciary duties.[51] Courts uphold a breach of fiduciary duty claim, and even award punitive damages derived from tort, while dismissing or ignoring contract claims.[52]

Nat'l Union Fire Ins. Co., 765 So. 2d 36, 38 (Fla. 2000) (distinguishing independent auditor's function from an advocate with undivided duty of loyalty owed to a client).

48. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at 90 (explaining that well written contracts obviate the need for fiduciary duties); *see also* Cook Biotech Inc. v. ACell, Inc., No. 03-CV-0046, 2005 WL 1473892, at *7 (N.D. Ind. June 21, 2005) (discussing the "well-established rule that contractual agreements do not give rise to a fiduciary duty").

49. Easterbrook & Fischel, *Contract*, *supra* note 1, at 427.

50. Southex Exhibitions, Inc. v. R.I. Builders Ass'n, 279 F.3d 94, 102 (1st Cir. 2002) ("[T]he labels the parties assign to their intended legal relationship, while probative of partnership formation, are not necessarily dispositive . . . ."); Martin v. Peyton, 158 N.E. 77, 79 (N.Y. 1927) ("[A]lthough they provide that they shall not be liable for any losses or treated as partners, the question still remains whether in fact they agree to so associate themselves with the firm as to 'carry on as co-owners a business for profit.'"); Murphy v. Holiday Inns, Inc., 219 S.E.2d 874, 876 (Va. 1975) ("When an agreement, considered as a whole, establishes an agency relationship, the parties cannot effectively disclaim it by formal 'consent'.").

51. *See, e.g.*, Victory Lane Prod., LLC v. Paul, Hastings, Janofsky & Walker, LLP, 409 F. Supp. 2d 773, 781 (S.D. Miss. 2006); Global Entm't, Inc. v. N.Y. Tel. Co., No. 00-CV-02959, 2000 WL 1672327, at *6 (S.D.N.Y. Nov. 6, 2000) (stating that fiduciary duties exist "separate and beyond any contractual duties"); Singleton v. Stegall, 580 So. 2d 1242, 1244 (Miss. 1991) (separating duty to comply with valid contract from duties of loyalty and care); April Enterp., Inc. v. KTTV, 195 Cal. Rptr. 421, 428 (Cal. Ct. App. 1983) ("[T]he conduct of the parties may create a joint venture despite an express declaration to the contrary.").

52. *See, e.g.*, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 20 Cal. Rptr. 3d 234, 265 (Cal. Ct. App. 2004).

Underwriters of initial public offerings (IPOs), for example, can owe a fiduciary duty to an issuer, notwithstanding contrary contractual language between the underwriter and the issuer. In one case, underwriters allegedly under-priced securities sold in an offering in return for payments from the purchasers. Notwithstanding a negotiated contract between the parties, the court upheld the lead managing underwriter's extra-contractual fiduciary duty. The underwriter maintained that a relationship between an issuer and an underwriter is "an arms-length commercial relation from which fiduciary duties do not arise." The court, however, stated:

> It may well be true that the underwriting contract, in which Goldman Sachs agreed to buy shares and resell them, did not in itself create any fiduciary duty. However, a cause of action for breach of fiduciary duty may survive, for pleading purposes, where the complaining party sets forth allegations that, apart from the terms of the contract, the underwriter and issuer created a relationship of higher trust than would arise from the underwriting agreement alone.[53]

This court looked beyond the agreed terms for evidence of a fiduciary relationship. One cannot say the parties were unable to specify contractual terms because they did so. If fiduciary duties were wholly contractual, such extra-contractual fiduciary claims would not survive.

Consider Justice Cardozo's opinion in *Meinhard v. Salmon*.[54] Contractualists argue that *Meinhard* can be best described through implied contractual terms.[55] A close look at Cardozo's disquisition and the underlying court record, however, demonstrates that Cardozo was not hobbled by the shackles of contract—he disregarded the parties' agreement and imposed extra-contractual fiduciary duties instead. In *Meinhard*, Walter Salmon leased the Hotel Bristol in New York City from Louisa Gerry for twenty years. Meinhard, the plaintiff, provided half the funds needed to renovate and operate the property, and Meinhard and Salmon divided responsibilities, profits, and losses. Four months before the end of the lease, Elbridge Gerry,

---

53. EBC I, Inc. v. Goldman, Sachs & Co., 832 N.E.2d 26, 31 (N.Y. 2005).

54. 164 N.E. 545 (N.Y. 1928).

55. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 439-40.

the new owner, renewed the lease with Salmon but Salmon did not mention the renewal to Meinhard. When Meinhard found out, he insisted the new lease be held in trust as an asset of the joint venture between Salmon and himself. Cardozo ruled for Meinhard. He held that Salmon, as a co-adventurer with Meinhard, was a fiduciary just like a partner, and Salmon could not appropriate the new lease in secrecy. Cardozo allotted Meinhard just under half of the value of the new lease.[56]

Contractualists argue that both the majority and dissent use a "contract-forcing" approach to resolve the case.[57] They maintain that Cardozo speculated that had Elbridge Gerry known Meinhard was a silent partner, Gerry would have offered the deal to Meinhard as well as Salmon, and Meinhard perhaps could have purchased an interest for himself or even out-bid Salmon.[58] By allowing Meinhard to purchase a partial interest in the new lease, the court "created the contract" the parties would have negotiated absent transaction costs.[59]

This analysis, however, is inconsistent with the contractual principle that actual terms trump implied terms. In *Meinhard*, the parties negotiated and drafted a detailed agreement, which prescribed their rights and responsibilities and limited them to twenty years. The agreement stated:

> [I:] [Salmon] hereby agrees to contribute and pay to [Meinhard], for and during the period of twenty (20) years from the first day of May, 1902, Fifty per centum of any and all moneys necessary to reconstruct, alter, manage and operate the Bristol Hotel property, at Fifth Avenue and Forty-second Street, leased to [Salmon] by Louisa M. Gerry, for a period of twenty (20) years from the first day of May, 1902 . . . .
>
> II: [Salmon] hereby agrees to pay to [Meinhard] for and during the period commencing on the first day of May, 1902, and ending on the first day of May, 1907, Forty per centum of the net profits arising out of the said Bristol Hotel property, leased to him as aforesaid, and thereafter, *i. e.*, [Salmon] agrees to pay to

56. *Meinhard*, 164 N.E. at 546-49.

57. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 440.

58. *Id.* at 439-40.

59. *Id.* at 440.

> [Meinhard] for the remaining fifteen (15) years of the term of the said lease, provided such lease shall not be sooner terminated, a sum equal to Fifty per centum of the net profits arising or growing out of the said leased premises, after deducting operating and managing expenses.[60]
>
> III: It is agreed between the parties hereto that each of the parties shall bear equally the losses, if any, arising or growing out of the aforesaid lease or the premises embraced therein, for and during the full term of said lease, *i. e.*, from the first day of May, 1902, to the first day of May, 1922 . . . .
>
> IV: It is further understood and agreed that this instrument shall not in any way effect the management and operation of the said Bristol Hotel property, but on the contrary [Salmon] shall have full power to manage, lease, underlet and operate the said premises . . . .
>
> . . . .
>
> It is understood in the event of the death of [Salmon] at any time before the terminatoin [sic] of this agreement, that no disposition shall be made of the lease hereinbefore referred to, without first consulting [Meinhard]. And should the personal representatives of [Salmon] decide to dispose of said lease to other parties for the term remaining, or to surrender the same to the lessor, it is agreed that said lease shall be offered, prior to such disposition or surrender, to [Meinhard], upon the same terms and conditions as said representatives intend to dispose of or to surrender the same, and he shall have the right of taking said lease for such unexpired term, upon said conditions.
>
> And in the event of the death of [Salmon] as aforesaid, it is understood that his personal representatives will and shall consult with [Meinhard], provided he is living, as to the management and operation of the said leased premises.[61]

Under the terms of this agreement, Meinhard agreed for a twenty-year period to pay fifty percent of the expenses associated with the Bristol; Salmon agreed to pay Meinhard forty percent of net profits for the first five years of their agreement (later changed to six) and fifty percent for the

---

60. Shortly after the agreement was signed, the parties revised this paragraph so that Meinhard received forty percent of net profits for the first six years, not five, and fifty percent for the remaining fourteen years, not fifteen years. Plaintiff's Exhibit 5 at 4,468, Meinhard v. Salmon 164 N.E. 545 (N.Y. 1928) (on file with author).

61. Plaintiff's Exhibit 3, Memorandum of Agreement at 4,441, Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) (on file with author).

remainder. Losses were to be split equally. Salmon was to have managerial responsibilities. The parties even specified Meinhard's future rights. If Salmon died before the lease expired, no disposition could be made of the lease without first consulting Meinhard. If Salmon's personal representatives decided to sell the lease to other persons or surrender it to Gerry, they were required to offer the lease to Meinhard on the same terms, and Meinhard had the right to take over the lease for the unexpired term. The agreement also provided the circumstances when Meinhard would be consulted about the management of the property. The agreement stated that the instrument would not affect the management and operation of the property and left control in Salmon's hands.[62] Only upon Salmon's death would his personal representatives consult Meinhard about the management and operations of the leased premises.[63]

A response might be that notwithstanding some detailed terms, Salmon and Meinhard did *not* agree about the eventuality that occurred here, namely when a renewal is offered to one party but not the other. The agreement, however, set forth the circumstances when Meinhard would have future rights regarding the property and a renewal was not included. More importantly, their responsibilities were to last only for a twenty-year period provided the lease was not terminated sooner.[64]

For the contractualists' account to be correct, they would have to claim that Cardozo was effectively writing the contract for the *next* twenty years. If that is the claim, however, Cardozo would be imposing a set of mandatory terms on the parties to last for the next twenty years. If two parties enter into a garden-variety contract for the first to perform a service for the second for twenty years, neither can require the other to continue to perform at the end of the term—the contract length was previously decided and specified. Courts only imply terms with respect to duration

62. *Id.* at 4,444-46.

63. *Id.* at 4,448-50.

64. *Id.* at 4,444; *see also* Geoffrey P. Miller, *Meinhard v. Salmon* 14 (N.Y. Univ. Law & Econ. Working Papers, Paper No. 105, 2007), *available at* http://lsr.nellco.org/nyu/lewp/papers/105 ("The contract between Meinhard and Salmon clearly contemplated an arrangement limited by the term of the original lease.").

where the contract is either silent or ambiguous.[65] Here, however, the term was express. Cardozo stepped outside of the contract and continued the obligation beyond the stated term. The actual terms did not give Meinhard the right to participate in a future arrangement.

Cardozo writes that Salmon probably thought that since the term of the venture was drawing to a close, Salmon could ignore Meinhard and take the next opportunity for himself. Cardozo even goes so far to say that Salmon would be right if the two were competitors.[66] Cardozo, however, shuns a contractual approach. Putting all of Cardozo's language about honor aside,[67] look at what he says: Meinhard had already been paid well under the agreement and insisting on more appears greedy.[68] Thus, the contract itself would militate against Meinhard prevailing. Cardozo, however, rejects a contractual approach, refusing to treat the parties as competitors who negotiate a contract and must live and die by its terms.[69]

Meinhard demonstrates the under-inclusivity of the contractual thesis. The parties negotiated a detailed contract, which excluded rights sought by the plaintiff. Notwithstanding the terms, Cardozo placed additional fiduciary duties on Salmon. This interpretation of the opinion debunks the contractual thesis put forth in a

---

65. *See, e.g.*, Guilbert v. Gardner, 480 F.3d 140, 149 (2d Cir. 2007) ("Where a contract does not specify a date or time for performance, New York law implies a reasonable time period."); Barco Urban Renewal Corp. v. Hous. Auth. of Atlantic City, 674 F.2d 1001, 1007 (3d Cir. 1982) ("When parties to a contract in a commercial setting fail to specify terms that are essential to a determination of their respective legal obligations, courts imply the omitted terms."); *see also* 1 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 424 (3d ed. 2004) ("Where no time is specified for performance of a duty such as that to deliver goods or pay the price, courts have had little difficulty in supplying a term requiring performance within a 'reasonable' time.").

66. Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928).

67. *Meinhard*, 164 N.E. at 546 ("A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.").

68. *See* Miller, *supra* note 64, at 15 ("The equities favored Salmon. Meinhard, as Cardozo recognized, had already been richly rewarded for his initial investment, substantially due to Salmon's capable management. Meinhard had done nothing other than cash checks.").

69. *Meinhard*, 164 N.E. at 548 (stating that the standard normally applying to competitors has no "pertinency" in the case).

leading article by Easterbrook and Fischel that perhaps the leading fiduciary duty case is a closet contractual decision.[70] Mandatory terms, such as those Cardozo placed on Salmon, are pervasive in fiduciary law and, as the next section shows, they cannot be dismissed as unimportant or trivial.

2. *Mandatory Terms as Important and Significant.* That courts, such as *Meinhard*, view fiduciary duties separately from contractual duties is itself evidence that such duties are mandatory and not enabling—they are externally imposed duties grounded in status, not in the interstices of contract. The Restatement of Torts states that principles applying to fiduciaries derive not from the contract or agreement between the parties, but rather from the parties' *relation*.[71] In this section, I respond to examples used to demonstrate the negotiable nature of fiduciary rules, focusing on trustees and corporate managers and directors.

a. *Trustees.* A trustee is generally prohibited from personally dealing in trust property. The Restatement of Trusts, discussed above, provides that rules barring the trustee from transacting with trust property can be waived.[72] John Langbein argues that virtually all of trust law consists of default rules that parties can alter in the trust agreement.[73] The relevant provision of the Restatement—section 222—however, does not state or imply that the trustee's duty of loyalty is negotiable; it simply permits exculpation in certain circumstances. The section states that "the trustee, by provisions in the terms of the trust, can be relieved of liability for breach of trust."[74] The Restatement goes on to distinguish between an exculpatory provision, such as section 222, and a provision limiting a trustee's duties.[75] The difference is important. An

---

70. Easterbrook & Fischel, *Contract*, *supra* note 1, at 438-40.

71. RESTATEMENT (SECOND) OF TORTS § 874 cmt. b (1979).

72. *See supra* notes 29-31 and accompanying text.

73. Langbein, *supra* note 1, at 636, 659.

74. RESTATEMENT (SECOND) OF TRUSTS § 222(1) (1959).

75. Section 222 provides in part as follows:

(2) A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or

exculpatory clause is a contractual provision relieving a party from certain liability resulting from a wrongful act.[76] It is similar to an exemption clause, which provides that a party will not be liable for damages for which the party would otherwise be liable absent the agreed term.[77] It operates like a release—an agreement to relinquish or abandon an existing claim.[78] It is not the same as a limitation on, or waiver of, a requirement to perform a duty.

Moreover, section 222 is not a complete exculpatory provision. First, it does not relieve a trustee of liability for profits derived from a breach.[79] Under section 222, if a trustee competes with a beneficiary and profits, the trustee may not retain the profits. Second, the parties may not insert terms that would permit the trustee to ignore the beneficiary's interests.[80] One purpose of a trust is to establish the trustee's duty to attend to the beneficiary's interests; a complete exculpatory clause would render the

---

intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.

RESTATEMENT (SECOND) OF TRUSTS § 222(2) (1959). The comments to subsection (2) distinguish explicitly between exculpation and limitation of duty:

> *c. Distinction between exculpatory provisions and those limiting trustee's duties.* If by the terms of the trust it is provided that the trustee shall not be under any duty to do or to refrain from doing an act which but for such provision it would be the duty of the trustee to do or refrain from doing, the trustee does not commit a breach of trust in doing or failing to do the act, unless such provision is ineffective as contrary to public policy. If, however, the trustee is not relieved of such a duty either because there is no provision to that effect in the terms of the trust or because such provision is ineffective as against public policy, a provision in the terms of the trust that the trustee shall not be liable for breach of trust is against public policy to the extent stated in Comment *b*.

Id. § 222(2) cmt. c.

76. *See* BLACK'S LAW DICTIONARY 588 (7th ed. 1999).

77. *See id.* at 593; P. S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACT 167 (3d ed. 1981).

78. *See* SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 73:1 (Richard A. Lord ed., 4th ed. 2003).

79. RESTATEMENT (SECOND) OF TRUSTS § 222(2) (1959); *see also id.* § 222(2) cmt. b.

80. *Id.* § 222(2) cmt. b (stating that no exculpatory clause applies for a breach committed with "reckless indifference to the interest of the beneficiary").

trustee unaccountable for his actions.[81] According to George G. Bogert, author of a leading treatise on the law of trusts, an exculpatory clause providing that the trustee is accountable to no one is not enforceable.[82] Consistent with the idea of a fiduciary core, courts note a "point beyond which" the parties cannot relieve a trustee from liability for breach of duty.[83] Section 222, therefore, does not provide that the parties can contract around the duty, only around personal liability for certain aspects of a breach.

Other provisions in the Restatement permitting the parties to revise trust terms are also limited in scope. A comment to section 174, for example, states that the requirement of "care and skill" may be "relaxed or modified."[84] It does not allow one to eliminate the duty of care, nor does it address the fiduciary duty of loyalty.[85] A comment to section 170 states that trust terms can empower a trustee to sell trust property to himself. The trustee, however, violates his duty if he acts in bad faith regardless of how broad the trust terms are drafted.[86] The most recent draft of the Restatement backs away from a wholly contractual view. A comment to section 78, Duty of Loyalty, states:

> Even an express authorization [to engage in prohibited transactions], however, would not completely dispense with the trustee's underlying fiduciary obligations to act in the interest of the beneficiaries and to exercise prudence in administering the trust. Accordingly, no matter how broad the provisions of a trust may be in conferring power to engage in self-dealing or other transactions involving a conflict of fiduciary and personal interests, a trustee violates the duty of loyalty to the beneficiaries by acting in bad faith or unfairly.[87]

The drafters say that the comment quoted above

---

81. *See In re* Green Charitable Trust, 431 N.W.2d 492, 499 (Mich. Ct. App. 1988).

82. GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 542 at 188 (rev. 2d ed. 1993).

83. *See* Browning v. Fidelity Trust Co., 250 F. 321, 325 (3d Cir. 1918).

84. RESTATEMENT (SECOND) OF TRUSTS § 174 cmt. d (1959).

85. *Id.*

86. *Id.* § 170 cmt. t.

87. RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (2007).

recognizes that the duty of loyalty entails more than default law: "[T]here are limits to the settlor's freedom, thereby protecting the fundamental fiduciary character of trust relationships recognized by law."[88] This reference is doubly important because it preserves an irreducible fiduciary core—the "fundamental fiduciary character"—and because it ties limitations on contractual freedom to the fundamental character of the relationship. The fundamental fiduciary character, in other words, is non-negotiable.

The fiduciary core in trust law is emphasized in the Employee Retirement Income Security Act (ERISA) of 1974.[89] Relying on *Firestone Tire & Rubber Co. v. Bruch*,[90] contractualists state that ERISA authorizes the use of trustees, who are appointed by management and may operate under a conflict of interest, acting simultaneously as fiduciaries to the plan and the corporation, which would be "unpardonable" under trust law.[91] As a result, the argument goes, ERISA's legislative scheme, as opposed to the common law of trusts, is contractual because an employer can appoint trustees, who may operate under a conflict and still receive broad discretion to interpret and apply the plan.

Firestone, however, does not expressly allow or advocate contractual freedom; to the contrary, *Firestone* is about when a court will exercise control over fiduciary decisionmaking. According to *Firestone*, a trust instrument can vary the trustees' discretion to construe terms and,

---

88. *Id.*

89. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 (2006).

90. 489 U.S. 101 (1989).

91. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 430. *See generally* Paul M. Secunda, *Inherent Attorney Conflicts of Interest under ERISA: Using the Model Rules of Professional Conduct to Discourage Joint Representation of Dual Role Fiduciaries*, 39 J. MARSHALL L. REV. 721, 730-32 (2006) (discussing conflicting dual role of ERISA fiduciaries). It is an exaggeration to say that conflicts are "unpardonable" in the law of trusts. A settlor can authorize a trustee to act in a dual capacity. Where a conflict of interest is permitted, a fiduciary will not be liable for his conduct unless he acts dishonestly, in bad faith, or abuses his discretion. *See, e.g.*, Dick v. Peoples Mid-Ill. Corp., 609 N.E.2d 997, 1002 (Ill. App. Ct. 1993) ("Where a conflict of interest is approved or created by the testator, the fiduciary will not be held liable for his conduct unless the fiduciary has acted dishonestly or in bad faith, or has abused his discretion.").

when a trustee is given discretion, a deferential standard of review of arbitrary and capricious is appropriate.[92] The deferential standard of review, however, is subject to control by the courts to prevent abuse by the trustee,[93] and one factor in determining whether abuse of discretion has occurred is whether the administrator or fiduciary is *operating under a conflict of interest*.[94] Thus, although the plan can allow for a conflict of interest by plan administrators, which is often inherent in their dual role, a conflict of interest gives rise to a stricter standard of review of their conduct.

Moreover, ERISA contains many nonnegotiable provisions, which demonstrate the mandatory nature of that particular legislative scheme. ERISA's exclusive benefit rule provides that an ERISA fiduciary shall discharge his duties "solely in the interest" of plan participants and for the "exclusive purpose" of providing them with benefits.[95] Another provision clarifies that plan assets "shall never inure" to the employer.[96] ERISA departs from the common law of trusts by voiding any provision purporting to "relieve a fiduciary from responsibility or liability."[97] Courts hold that contracts alleviating fiduciaries from performing their fiduciary responsibilities are invalid[98] and commenters note that ERISA "transforms

92. *Firestone*, 489 U.S. at 115.

93. *See id.* at 111 (quoting RESTATEMENT (SECOND) OF TRUSTS § 187 (1959)).

94. *See* RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. d (1959) (stating that in determining "whether the trustee is guilty of an abuse of discretion" one relevant circumstance is "the existence or nonexistence of an interest in the trustee conflicting with that of the beneficiaries"), *quoted in Firestone*, 489 U.S. at 115. The Supreme Court has granted certiorari to resolve the issues of (1) whether a claim administrator that also funds an ERISA plan leads to a conflict of interest that must be weighed in a determination of judicial review, and (2) how such a conflict, if it exists, should be addressed on judicial review of a discretionary benefit determination. *See* Glenn v. Metlife, 461 F.3d 660 (6th Cir. 2006), *cert. granted*, No. 06-923, 2008 WL 161473 (Jan. 18, 2008).

95. Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1104(a)(1)(A) (2000).

96. *Id.* § 1103(c)(1).

97. *Id.* § 1110(a).

98. *See* Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 568 (1985) ("[T]rust documents cannot excuse trustees from their duties under ERISA . . . ."); IT Corp. v. Gen. Am. Life Ins. Co., 107 F.3d 1415, 1418 (9th Cir. 1997) ("[A] contract exonerating an ERISA fiduciary from

default law into mandatory law."[99]

Contractualists could respond that even if fiduciary rules are mandatory, they stand in for the parties' agreement and are efficient because the parties would not pursue an agreement that does not maximize joint wealth. Fiduciary rules, however, are often highly inefficient because they limit the parties from engaging in the private ordering essential to contractual relationships.[100] In trust law, the fiduciary must abstain from transacting with his principal even when the fiduciary places a higher value than other potential bidders on trust assets and is willing to outbid the competition.[101] The Restatement of Trusts says that a trustee, who bids for the purchase of trust property for his own account may not keep the property even if he secured as many bidders as possible and his bid was fair.[102] John Langbein observes that the sole benefit rule of trust law is "value impairing."[103] The same is true in other areas of the law too numerous to review here.[104] Thus, although

---

fiduciary responsibilities is void . . . .").

99. JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 682 (3d ed. 2000).

100. *See* TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 123 (2006); *id.* at 149 ("[F]iduciary rules are inefficient because they severely limit the fiduciaries' freedoms to engage in tempting (*but not fraudulent*) transactions.").

101. *See, e.g.*, Magruder v. Drury, 235 U.S. 106, 120 (1914) ("It makes no difference that the estate was not a loser in the transaction . . . ."); Hartman v. Hartle, 122 A. 615 (N.J. Ch. 1923) (finding that a trustee or spouse cannot purchase trust property from himself and must disgorge profits even when fair value was paid).

102. RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. b (1959) ("A trustee with power to sell trust property is under a duty not to sell to himself either by private sale or at auction, whether the property has a market price or not, and whether or not the trustee makes a profit thereby. It is immaterial that the trustee acts in good faith in purchasing trust property for himself, and that he pays a fair consideration."). As discussed, the exculpatory clause provision in section 222 provides that an exculpatory provision is not effective to relieve the trustee of liability for profit the trustee derives from a breach of trust. *Id.* § 222(2).

103. John H. Langbein, *Questioning the Trust Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 952 (2005).

104. The classic example in partnership law is *Marsh v. Gentry*, 642 S.W.2d 574 (Ky. 1982). John Marsh and Tom Gentry formed a partnership to buy and sell thoroughbreds. *Id.* at 575. Without telling Marsh, Gentry offered to purchase Champagne Woman and Excitable Lady through a third person. The court refused to uphold the sales stating that partners must act with a high

courts may arrive at default contractual terms, these terms are not necessarily efficient, nor are they meant to be.

b. *Corporate Officers and Directors.* Contractualists maintain that corporate law in general and corporate fiduciary duties in particular supply terms that the parties would have negotiated given unlimited resources. Central to the claim is that the default terms merely supplement, but do not replace, actual terms negotiated by the parties. The few instances when the default rules are mandatory, they say, are unimportant to the daily life of the firm.[105] As an example of this model in action, contractualists point to provisions in corporate law, such as section 102(b)(7) of the Delaware code, which permits charter amendments limiting the duty of care.[106] Robert Clark observes that a corporation can ask its shareholders to vote to "opt out" of the common

---

degree of good faith. *Id.* at 576. The relevant Kentucky statute provided that a partner must account for any benefit derived from a transaction connected with the partnership unless consent was obtained. A partner has a right to know when his partner is the buyer. *Id.* Marsh claimed he would not have consented to the sale had he known Gentry was the purchaser. The dissent, however, noted that the partnership as a whole would have been better off as a result of Gentry's purchase. *Id.* at 578 (Stephenson, J., dissenting). The bidding for Champagne Woman halted at $60,000 except for Gentry's agent, who bid $135,000. The dissent explained that Marsh was better off with Gentry as purchaser than if the horse were sold for $60,000. *Id.*

We can surmise from the bidding that Gentry valued Champagne Woman at $135,000 or more ($75,000 over the next highest bid). In retrospect, one can ask whether Marsh would have accepted a payment between $1 and $75,000 to allow Gentry to bid anonymously for the thoroughbreds. It is impossible, however, to second-guess what actual bargain the parties would have struck. Perhaps they would have agreed that a partner may never purchase partnership property absent advance disclosure. Or perhaps they would have agreed either partner could do so in the ordinary course and at arm's length, as Gentry did here. Perhaps they would have struck a deal where one partner could bid anonymously for partnership assets but only if the bid were sufficiently high to provide a premium for non-disclosure. Ascertaining what the parties would have bargained for in a costless market is difficult. *See* Jules Coleman, *The Normative Basis of Economic Analysis: A Critical Review of Richard Posner's* The Economics of Justice, 34 STAN. L. REV. 1105, 1109 n.6 (1982) (book review). Regardless, Gentry's fiduciary obligation precluded an efficiency analysis advocated by the dissent and frustrated a transaction that enhanced value to both parties.

105. *See* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 1, at 3, 34.

106. *See supra* note 35 and accompanying text; Butler & Ribstein, *supra* note 1, at 4; Macey, *supra* note 1, at 1271-72.

law rules of fiduciary duty.[107]

Section 102(b)(7) of the Delaware code, however, does not permit a general "opt out" of the duty of care. It permits limited exculpation with respect to one remedy—personal liability for money damages—where there has been a breach of the duty of care by directors.[108] Like exculpation in trust law, section 102(b)(7) was not intended to negate the director's duty, but rather to remove liability for personal damages. According to the official commentary of the Delaware legislature, the provision has no effect on equitable remedies for breach of fiduciary duty, such as actions for an injunction or rescission[109] and it does not exculpate directors from duties of disclosure.[110] Moreover, recent developments in Delaware suggest that section 102(b)(7) will not exculpate directors from many traditional duty of care claims because courts have begun to place such claims under the category of loyalty, not care, and a breach of the duty of loyalty is not subject to exculpation.[111]

Contractualists also argue that fiduciary duties are negotiable because managers can change corporate form and shed their responsibilities. They can reincorporate in another state, for example, or take a company private or

---

107. Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1704 (1989).

108. *See* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1791 n.150 (2001) (rejecting characterization that section 102(b)(7) permits opting out of duty of care).

109. S. 533, 133d D. Gen. Assembly 2, 5 Del. Laws, ch. 289, §§ 1-2 (1986) (commentary to section 102(b)(7)), *quoted in* 1 EDWARD P. WELCH, ANDREW J. TUREZYN & ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 102.15.1 at GCL-I-28 to -29 (5th ed. 2007); *see also* Robert P. McKinney, *Protecting Corporate Directors and Officers: Indemnification*, 40 VAND. L. REV. 737, 759 (1987).

110. *See* Zirn v. VLI Corp., 621 A.2d 773, 783 (Del. 1993) ("[T]he legislative history of the statute authorizing this provision . . . indicates that corporations are empowered to shield directors from breaches of the duty of care, not the duty of loyalty, which also embraces the duty of disclosure . . . .").

111. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006) (finding that oversight liability is a violation of the duty of loyalty, not care); Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003) (finding that a traditional duty of care claim now requires a showing that directors breached their duty of loyalty by neglecting to fulfill duties in good faith).

convert to a partnership or limited liability company.[112] Bernard Black calls this strategy "avoidance" and says it is one reason mandatory rules in corporate law are trivial.[113]

As a practical matter, it is not so easy to change corporate form.[114] But even if managers have the ability to change corporate form, such flexibility does not render fiduciary rules enabling. A motorist can decide to walk or ride a bicycle rather than drive, but that does not make our traffic laws and driving rules any less mandatory. Similarly, the rules of tennis are mandatory—a ball that falls behind the baseline is out. The rules become no less mandatory because the players forgo a game of tennis and play squash instead. To say investors can vote with their feet, or firms can reincorporate in another state or opt for a governance structure with a different set of mandatory rules, does not make the rules themselves enabling.

The law of insider trading is a variation on this theme. Corporate insiders and other fiduciaries that possess material, non-public information must either disclose the information or abstain from trading.[115] Some argue that in deciding insider trading cases, courts take a contractual approach, such as imputation of terms, in determining who owns non-public information—a form of property—and,

---

112. *See* Macey, *supra* note 1, at 1271; *supra* text accompanying note 37.

113. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 555-61 (1990).

114. *See* Miller v. Ross, No. 600986-06, 2007 N.Y. Misc. LEXIS 637, at *12 (N.Y. Sup. Ct. Feb. 6, 2007) (nullifying conversion of New York limited partnership to Delaware LLC absent consent of majority of each class of limited partners); Berger v. Scharf, 816 N.Y.S.2d 693 (unpublished table decision), No. 600935-2005, 2006 WL 825171, at *8 (N.Y. Sup. Ct. Mar. 29, 2006) ("A plaintiff states a valid claim under Delaware law for breach of fiduciary duty by alleging particular facts showing that the directors decided to delist for self-interested reasons . . . ."); *see also* Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports under Section 13(a) or 15(d), Exchange Act Release No. 34-55005, 72 Fed. Reg. 1384 (Jan. 11, 2007) (describing the "burdens and uncertainties associated with terminating registration and reporting under the Exchange Act").

115. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) ("[A]nyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.").

therefore, when liability arises.[116] The laws governing insider trading, in other words, just help write the corporate contract that would be negotiated between directors, managers, employees, and others, if given unlimited resources. Cases cited to support this proposition, however, suggest the opposite. The law of fiduciary duties propounded in insider trading cases is extra-contractual law imposed on the parties.

Take the example of *SEC v. Cherif*.[117] *Cherif* is a misappropriation case decided by the Seventh Circuit before the Supreme Court endorsed the misappropriation theory in *United States v. O'Hagan*.[118] The defendant, Danny Cherif, worked at First National Bank of Chicago until he was terminated in 1987. Using his identification card, which he kept under false pretenses, Cherif was able to enter the office of his previous employer and obtain confidential information about upcoming transactions. Based on the information, he traded and profited from the trades.[119] The Securities and Exchange Commission (SEC) sued on the misappropriation theory of insider trading.

Under the misappropriation theory, liability arises when a person breaches a fiduciary duty to any lawful possessor of material, non-public information—not just the corporation itself or its shareholders.[120] Cherif argued that the misappropriation theory was not applicable because no fiduciary duty existed between him and First National Bank after 1987 when his employment terminated.[121]

---

116. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 440.

117. 933 F.2d 403 (7th Cir. 1991), *cited in* Easterbrook & Fischel, *Contract*, *supra* note 1, at 440 n.36.

118. 521 U.S. 642, 655 (1997). Under the classical theory of insider trading, a corporate insider trades on the basis of material non-public information in breach of a duty of trust and confidence between the insiders and the shareholders. Under the misappropriation theory, a person, not necessarily a company insider, misappropriates confidential information to trade securities in breach of a duty owed to the source of the information. Instead of basing liability on a fiduciary relationship between the insider and the shareholder who buys or sells, liability under the misappropriation theory is based on deceiving those who entrusted the trader with non-public information. *See id.* at 652.

119. *Cherif*, 933 F.2d at 406.

120. *See id.* at 409.

121. *Id.* at 408.

Cherif maintained that an integrity policy he signed prevented him from using information he obtained only while on the job and that the restrictions terminated with his employment.[122] The court, however, avoided a contractual approach to determining whether he had a duty not to trade stating: "Notwithstanding the contractual agreement, Cherif was bound by a broader common law duty."[123] The court opted to enforce a general principle preventing former employees from disclosing non-public information, regardless of contractual terms. In Part III, I return to the topic of insider trading and argue that a property approach grows out of a prior duty owed between the parties and not out of ownership principles themselves.

In summary, the contractual model cannot fully explain fiduciary rules. The model is both over- and under-inclusive and it fails to address a fiduciary core that is not negotiable. The duty of loyalty precludes the fiduciary from engaging in precisely the type of conduct that contractualists advocate.[124] If the contractual model is incomplete, what explains the core fiduciary obligation, which is not subject to negotiation? The next Part demonstrates that the core fiduciary duty is a duty to adopt the principal's goals, objectives, or ends.

II. THE ADOPTION OF ENDS

In this Part, I sketch a view of the fiduciary obligation that better explains the central tendency of fiduciary cases. This view is based not on efficiency concerns, but rather on the idea of duty itself, which entails a commitment by the fiduciary to adopt the principal's objectives, goals, or ends as the fiduciary's own and to promote those ends. The emphasis on duty places this view within deontological moral theory. Deontology asks whether an act is required, permitted, or prohibited by a moral duty irrespective of, or at least not wholly dependent upon, the overall consequences attached to the act.[125] One common conception of deontology

122. *Id.* at 411.

123. *Id.*

124. *See* Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185, 187-93 (Lawrence E. Mitchell ed., 1995).

125. STEPHEN DARWALL, PHILOSOPHICAL ETHICS 81 (1998) (explaining that

is one's moral duties must be understood in connection with agent-relative maxims that require, permit, or prohibit particular acts, and violating those maxims is morally wrong.[126] The ends do not necessarily justify the means. This deontological conception of duty is what lies at the heart of the fiduciary relationship. The fiduciary's adoption of the principal's objectives or ends, regardless of the overall consequences of doing so, is the unifying theme in fiduciary cases. It is what makes fiduciary law unique and separates fiduciaries from other service providers.

This Part first explains that the core duty of the fiduciary is to adopt the ends of the principal and act to promote those ends. It then discusses how the Restatement of Agency conceptualizes the fiduciary duty in this manner. Next, this Part explains that the duty to adopt another's end is grounded in Kant's system of duties. The duty to adopt an end is a duty of ethics—and an imperfect duty—in Kant's system. This Part ends by noting that courts deciding fiduciary cases examine the fiduciary's motive for acting or not acting and try to determine whether the fiduciary was inspired to promote the ends of the principal or to promote some other—inappropriate—objective.

A. *Pursuing the Principal's Ends*

I begin by identifying formulations of the core fiduciary obligation that cannot be eliminated by the parties through contract. Let's look at some examples. The Uniform Partnership Act (UPA) provides that, although partners can identify particular activities that may not violate the duty of loyalty, they cannot renegotiate the duty of loyalty or unreasonably reduce the duty of care.[127] In defining the content of the duty of loyalty, the UPA provides that a partner must "account to the partnership" and "hold as trustee" for the partnership any benefit the partner derives from the conduct of the partnership business or use of

---

deontology, unlike consequentialism, holds that "there are right- and wrong-making considerations other than good and bad effects"); SHELLY KAGAN, NORMATIVE ETHICS 73 (1998) (explaining that deontology presupposes "constraints, which erect moral barriers to the promotion of the good").

126. *See, e.g.*, Heidi M. Hurd, *The Deontology of Negligence*, 76 B.U. L. REV. 249, 253 (1996); J. L. MACKIE, ETHICS: INVENTING RIGHT AND WRONG 149 (1990).

127. UNIF. P'SHIP ACT § 103(b), 6 U.L.A. 73 (1997).

partnership property, including the taking of a business opportunity.[128] The comment to the UPA states that these provisions are intended to protect a "fundamental core" of the fiduciary obligation that cannot be eliminated by contract.[129]

Similarly, the Restatement of Trusts provides that the trustee is under a duty to administer a trust "solely in the interest of the beneficiary."[130] Recall that the Restatement of Trusts, quoted above, provides that even if the parties had agreed to an express authorization, the authorization "would not completely dispense" with an underlying fiduciary duty to act in the best interest of the beneficiaries (the duty of loyalty) and exercise prudence in administration of the trust (duty of care).[131] The ERISA statute, as discussed above, goes further. An ERISA fiduciary must act *solely in the interest* of the participants and for the *exclusive purpose* of their benefit.[132]

1. *The Fiduciary's Role.* What does it mean to act *for the benefit* or *in the interest* of the principal? Don't all service providers act for another's benefit?[133] Although fiduciary relationships often are considered agency relationships, a fiduciary is a special type of agent. Agency is defined in the Restatement of Agency as consent by the principal that the agent act on the principal's behalf and subject to the principal's control, and the agent agrees to so act.[134] Historically, determining whether an agency relationship existed turned on the agent's *lack* of autonomy. The principal's control of the agent resulted in an agency relationship; lack of control militated against agency and in favor of some other type of relationship, like an independent contractor.[135] Fiduciaries are different. Although the principal has nominal control over the agent at the outset of the relationship, the control dynamic is reversed; when performing its function, the fiduciary exercises control over the assets or affairs of the principal.[136] The principal may

128. UNIF. P'SHIP ACT § 404(b), 6 U.L.A. 143 (1997).

129. UNIF. P'SHIP ACT § 103(b) cmt. 4, 6 U.L.A. 74 (1997).

130. RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959).

131. RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (2007); *see also supra* text accompanying note 87.

132. *See supra* note 95 and accompanying text.

decide whether to enter the relationship in the first place, but the relationship is not co-equal; the fiduciary obtains control over the principal. To create a valid trust, for example, the settlor must transfer sufficient authority and discretion to the trustee and the beneficiary's interest must vest at the time of transfer.[137] Thus, the fiduciary has power over the principal and, at the same time, must act for the principal's benefit.

Given the infinite number of actions available for the fiduciary to pursue, how does he determine what actions will benefit the principal? The answer is the fiduciary must become aware of the principal's subjective purposes, objectives, or ends and adopt the principal's ends as the fiduciary's own ends. When a person has an end, we expect the person to be sensitive to facts associated with the end

---

133. *See* Lionel Smith, *The Motive, Not the Deed*, *in* RATIONALIZING PROPERTY, EQUITY AND TRUSTS: ESSAYS IN HONOUR OF EDWARD BURN 53, 64 (Joshua Getzler ed., 2003) ("It is not uncommon for one person to have a positive duty to advance the interests of another. If I make a contractual promise to you that I will put a new roof on your house, I have a positive duty to advance your interests.").

134. RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

135. *See* Hoover v. Sun Oil Co., 212 A.2d 214, 216 (Del. Super. Ct. 1965) (denying agency relationship because "Sun had no control over the [details] of Barone's day-to-day operation"); Humble Oil & Refining Co. v. Martin, 222 S.W.2d 995, 998 (Tex. 1949) (finding an agency relationship because of "evidence bearing on the right or power of Humble to control the details of the station work").

136. *See, e.g.*, United States v. Skelly, 442 F.3d 94, 99 (2d Cir. 2006) (noting that "'reliance and de facto control and dominance'" are necessary for a fiduciary relationship (quoting United States v. Szur, 289 F.3d 200, 210 (2d Cir. 2002))); Hi-Ho Tower, Inc. v. Com-Tronics, Inc., 761 A.2d 1268, 1280 (Conn. 2000) (stating that "control, dominance or influence [is] characteristic of fiduciary relationships"); *see also* Mitchell, *supra* note 124, at 188-89 (differentiating fiduciary relationships from other economic and legal relationships by discretion vested in fiduciary and lack of control on part of principal).

137. Although the settlor can reserve income from the trust estate for himself, as well as the right to revise the trust or even disapprove of investments, the interest of the trust must pass to the trustee. *See* Denver Nat'l Bank v. Von Brecht, 322 P.2d 667, 672 (Colo. 1958) ("Where, as here, the property involved in a trust is assigned, transferred and set over to the trustee and remains in the name of the trustee, the interest of the settlor therein passes to the trustee in presenti . . . ."); *In re* Estate of Groesbeck, 935 P.2d 1255, 1258 (Utah 1997) (upholding trust where legal title passed to trustees although settlors reserved power to access trust assets without formal authorization of trustee).

and to the subtle ways to promote it.[138] This sensitivity separates fiduciaries from other service providers.

Although most service providers pursue an objective or goal of benefiting a consumer, the task of most service providers is discrete, such as repairing, installing, building, or paving. If the task is not completed, these service providers have not done their job. Fiduciary services are different; they entail a series of open-ended actions over time. Such actions are not expected to be perfect or correct in all cases; they are scrutinized under a "range of reasonableness" test.[139] Lawyers, for example, can lose many of their cases and still practice consistently with their fiduciary obligations. Although winning a client's case is the goal, winning is not essential to performing the lawyer's task the way a successful repair is essential to the repairman's task. Particularly under the adversarial system, it would be uncommon for an attorney to win every case and courts recognize that a lawyer is not a guarantor of results.[140]

The fiduciary's role is more subtle than completing a particular task. The fiduciary's knowledge and skill lead to role identification with the principal.[141] Fiduciaries often act in the name and place of the principal.[142] They receive and analyze information and make difficult judgments about whether and how to respond.[143] Although many professionals undertake to act on another's behalf, the

---

138. *See* Christine Korsgaard, *Morality as Freedom*, *in* KANT'S PRACTICAL PHILOSOPHY RECONSIDERED 23, 44 (Yirmiyahu Yovel ed., 1989).

139. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 931 (Del. 2003).

140. *See* Helmbrecht v. St. Paul Ins. Co., 362 N.W.2d 118, 130-31 (Wis. 1985) (stating that attorney is not a "guarantor" of results for client); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52 cmt. b (2000) (stating that the duty of competence does not make a lawyer a guarantor of a successful outcome).

141. *See* Gerald J. Postema, *Moral Responsibility in Professional Ethics*, 55 N.Y.U. L. REV. 63, 77 (1980) ("[A]t the invitation of the client, the lawyer becomes an extension of the legal, and to an extent the moral, personality of the client.").

142. A typical power of attorney authorizes another to act "[i]n my name, place and stead, in any way which I myself could do, if I were personally present" with respect to certain matters. N.Y. GEN. OBLIG. LAW § 5-1501 (McKinney 2007).

143. *See* Postema, *supra* note 141, at 76.

fiduciary's agency is deeper. When the fiduciary speaks, argues, negotiates, and transacts, he does so in his client's name to further the client's ends, and binds the client to a determinate future.[144]

The fiduciary's role identification with the principal requires him to reorient his moral viewpoint away from pursuing the overall best state of affairs to furthering agent-relative objectives. Just like spouses, parents, and friends prefer the interests of those closest to them over others, fiduciaries must use their expertise to promote their principals' ends over the ends of others and be indifferent to overall consequences that would normally bear upon one's behavior.[145] John Pomeroy, in his famous treatise, Equity Jurisprudence, explained that when analyzing whether a transaction with a fiduciary constitutes a breach of fiduciary duty, it makes no difference if the sale was fair, full consideration was paid, or the price was the highest that could be obtained.[146] The Supreme Court long ago overturned the purchase of property for sale at a public auction by two executors of a will even though the price was fair.[147] Similarly, a trustee who transacts in trust property for his or her own account cannot defend a breach of duty claim by maintaining that the price was fair and the transaction did not cause harm.[148]

Some courts formulate the fiduciary obligation as a duty to treat the principal as the fiduciary would treat

---

144. *See* Deborah A. DeMott, *Disloyal Agents*, 58 ALA. L. REV. 1049, 1051 (2007) ("[A]n agent acts with power to affect the principal's legal relations by creating rights or obligations applicable to the principal or by acquiring knowledge of facts with which the principal is charged. The central idea is that an agent serves a representative function and does not simply provide a service.").

145. *See* Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 HUM. RTS. 1, 5 (1975).

146. 3 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 958 (Spencer W. Symonds ed., 5th ed. 1941) (explaining that the "policy of equity is to remove every possible *temptation* from the trustee").

147. *See* Michoud v. Girod, 45 U.S. (4 How.) 503, 555 (1846) ("The disability to purchase is a consequence of that relation between them which imposes on the one a duty to protect the interest of the other, from the faithful discharge of which duty his own personal interest may withdraw him.").

148. *See* Hartman v. Hartle, 122 A. 615 (N.J. Ch. 1923); *supra* notes 101-03 and accompanying text.

himself.[149] Some even use the phrase "alter ego" to reference the fiduciary norm.[150] This personalizes the duty in a particular way. The fiduciary must appropriate the objectives, goals, or ends of another and then act on the basis of what the fiduciary believes will accomplish them—a happy marriage of the principal's ends and the fiduciary's expertise. The fiduciary does not eliminate its own legal personality, rather it must consider the principal's delegation of authority to the fiduciary from the perspective of fidelity to the principal's objectives as the fiduciary understands them. According to the Restatement of Agency, the fiduciary has the obligation to consider the principal's delegation of authority, or any instruction by the principal to the fiduciary, and to interpret the delegation or instruction "so as to infer, in a reasonable manner, what the principal would wish the agent to do in light of the facts of which the agent has notice at the time of acting."[151] The next section expands on the fiduciary obligation as a process of interpreting the principal's instructions.

2. *The Adoption of Ends as a Rule of Interpretation.* The Restatement of Agency conceptualizes the fiduciary duty as the duty to adopt the principal's ends, articulating the duty in terms of the fiduciary's *interpretation* of the principal's directive.[152] As mentioned, fiduciary relationships, like other agency relationships, entail consent by the principal that the fiduciary will act on the principal's behalf and subject to the principal's control.[153] These essential requirements for agency presuppose that the principal will instruct the agent on how to act. At the time the fiduciary acts, therefore, it will be required to interpret language the principal uses in its instructions or otherwise assess the

149. In *Burdett v. Miller*, 957 F.2d 1375 (7th Cir. 1992), Judge Posner wrote: "A fiduciary duty is the duty of an agent to treat his principal with the utmost candor, rectitude, care, loyalty, and good faith—in fact to treat the principal as well as the agent would treat himself." *Id.* at 1381.

150. *See* United States v. Dial, 757 F.2d 163, 168 (7th Cir. 1985) ("The essence of a fiduciary relationship is that the fiduciary agrees to act as his principal's alter ego . . . .").

151. RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. g (2006).

152. I thank Deborah DeMott for pointing this out.

153. *See* RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

principal's conduct for relevant cues as to how to act.[154] According to the Restatement, interpretation is called for regardless of whether the fiduciary is acting under explicit written instructions, a general directive, or has simply been appointed to a fiduciary position and received no guidance whatsoever, such as a court appointed attorney or a new employee in a large organization.[155]

The principal's directive—even one that appears clear on its face—may raise ambiguities that could result in the fiduciary interpreting the instructions differently from what the principal intended.[156] The instructions, for example, may be clear, but incomplete, or the agent may understand the instructions to grant discretion.[157] A fiduciary must interpret the principal's instructions in a reasonable manner to further the principal's purposes of which the agent is or should be aware at the time of acting. According to the comments in the Restatement, "[t]he agent's fiduciary duty to the principal obliges the agent to interpret the principal's manifestations so as to infer, in a reasonable manner, what the principal desires to be done in light of facts of which the agent has notice at the time of acting."[158] Under this view, the fiduciary is not free to take advantage of loopholes or ambiguities contained in the principal's directive to promote its own interest or the interest of third persons.[159]

This rule of interpretation—interpreting the principal's instructions consistent with the adoption of ends—is justified because it helps ensure that the principal not bear the risk that the agent will take advantage of ambiguities in the delegation of authority from the principal to the fiduciary. The rule of interpretation also saves resources. Under it, the principal can live without a fully specified agreement and does not have to concern itself with

---

154. *See* RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. f (2006).

155. *See id. But see* Dennis Patterson, *The Poverty of Interpretive Universalism: Toward the Reconstruction of Legal Theory*, 72 TEX. L. REV. 1, 3 (1993) (criticizing the notion that comprehension of every text or verbal act is a matter of interpretation).

156. *See* RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. f (2006).

157. *Id.*

158. *Id.*

159. *See id.* § 1.01 cmt. e.

modifying its instructions to the fiduciary, providing interim instructions over the course of the fiduciary relationship, or eliminating contingencies that the fiduciary could potentially exploit.[160] Instead, the principal has the comfort of knowing that the rule of interpretation will govern the fiduciary's conduct—the fiduciary will interpret the initial instructions to further the principal's ends. The rule entitles the principal "not to have to wonder about the fiduciary's motive."[161]

B. *Imperfect Duty*

A positive duty to adopt the principal's ends is not the way courts and commentators traditionally have formulated the fiduciary obligation. Indeed, both economic and non-economic accounts of the fiduciary relationship suggest that the fiduciary duty is primarily negative. The literature is dominated by the idea that the fiduciary duty is a device to address agency costs and constrain fiduciary misconduct, such as self-dealing.[162] Even the U.S. Supreme Court has

---

160. *See id.* In some cases, a detailed agreement may be undesirable because the fiduciary will decide it can ignore certain items as unimportant or as inadvertent obstacles to furthering the principal's overarching goal. *See id.* § 2.02 cmt. f. The rule of interpretation—also called a *fiduciary benchmark*—is especially relevant in the case of corporations or other large organizational principals. The rule simplifies the process by which directions are delivered, understood, and executed. *See id.* § 1.01 cmt. e. It eliminates the need to draft instructions with the specificity that characterizes agreements between parties operating at arm's length.

161. Smith, *supra* note 133, at 75 (emphasis omitted).

162. *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 915 (stating that "the only general assertion" about the fiduciary obligation that can be made is that it is a device designed to control one's discretion); Frankel, *supra* note 2, at 1224 n.37 ("The main thrust of fiduciary law is . . . to prevent [the fiduciary] from misappropriating another person's valuables."); Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983); Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1 (1975) (asserting the fiduciary obligation is necessary to control the fiduciary's discretion and avoid conflicts); *see also* Butler & Ribstein, *supra* note 1, at 29 (stating that alternative to highly specified contracts is to "constrain the parties to act for their mutual benefit"); Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55 (John W. Pratt & Richard J. Zeckhauser eds., 1985); Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U. L. REV. 1, 1 (1985) ("Through the fiduciary device, the law seeks to create a system of compensation and deterrence to protect the principal's interests against exploitation which results from that divergence."); Frank H.

written that the function of the fiduciary obligation is to constrain the fiduciary's discretion.[163] Control of discretion, however, is only one aspect of the obligation and accentuating the negative detracts from the importance of motivating the fiduciary to further the principal's objectives.

The account of the fiduciary obligation as the duty to adopt the principal's ends draws on Kant's development of duties of ethics, and imperfect duties, in both his *Foundations of the Metaphysics of Morals*[164] and *The Metaphysics of Morals*.[165] In *The Metaphysics of Morals*, Kant investigated the Categorical Imperative developed in the *Foundations*. At the time he wrote the *Foundations*, Kant stated in the preface that it was meant to be preliminary to a *Metaphysics of Morals*, which he would eventually complete.[166] His aim in the *Foundations* was the "search for and establishment of the supreme principle of morality."[167] This aim was a project unto itself; Kant explained that application of the principle at the early stage of the *Foundations* could be disadvantageous because the appearance of its usefulness could inhibit a complete investigation of the principle independent of its consequences.[168] Twelve years later, in *The Metaphysics of Morals*, Kant sought to derive from the Categorical Imperative a comprehensive system of duties. Unlike the *Foundations*, *The Metaphysics of Morals* applies the Categorical Imperative to derive particular duties.[169]

Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983) (explaining fiduciary duties as a constraint on managers to use sound judgment on behalf of shareholders).

163. *See* Varity Corp. v. Howe, 516 U.S. 489, 504 (1996) ("[T]he primary function of the fiduciary duty is to constrain the exercise of *discretionary* powers . . . .").

164. KANT, FOUNDATIONS, *supra* note 9.

165. KANT, METAPHYSICS OF MORALS, *supra* note 9.

166. KANT, FOUNDATIONS, *supra* note 9, at *391.

167. *Id.* at *392.

168. *See id.*

169. *The Metaphysics of Morals* is a "systematic application of [the Categorical Imperative], a procedure which implies a patient search for criteria through which duties can be derived, step by step, from the [C]ategorical [I]mperative." GREGOR, *supra* note 9, at xii (discussing Immanuel Kant's *Metaphysics of Morals*).

1. *Kant's System of Law and Ethics.* The fiduciary's obligation to adopt the principal's objectives or ends is an "imperfect" duty in Kant's system. What are imperfect duties and how are they relevant to the fiduciary obligation? Kant divides rights and duties into two systems—juridical and ethical—outlined in the two parts of *The Metaphysics of Morals*—the *Metaphysical First Principles of the Doctrine of Right* and the *Metaphysical First Principles of the Doctrine of Virtue.*[170] In the *Doctrine of Right*, Kant takes up juridical (or legal) rights, which regulate external actions and which can be enforced by external means, such as legal sanctions, independently of one's moral attitude.[171] In the *Doctrine of Virtue*, he takes up ethical duties, which can only be enforced by self-constraint.[172]

If the threat of external sanction, such as a fine or imprisonment, provides the incentive for a person to perform an action, the law requiring the action is juridical. If the law itself, not an external sanction, provides the reason to perform an action, then the law requiring the action is an ethical law. A law requiring one to keep a promise made in contract, for example, is related to an external action—taking the steps to perform the contract—and is enforceable by the promissee going to court. The law, therefore, is juridical. But a command to keep a promise merely because it is a duty, regardless of other incentives, is an ethical law.[173]

Kant similarly conceived of a broad set of duties, which he divided into ethical duties and juridical duties. Ethical duties (or duties of virtue) parallel ethical laws and can be enforced by internal constraint. Within the set of ethical duties lies a subset of duties, which Kant calls juridical (or legal) duties, which parallel juridical laws. These juridical

---

170. KANT, METAPHYSICS OF MORALS, *supra* note 9. Kant distinguished between juridical laws and ethical laws—two categories of moral laws. Kant separately discussed laws of nature, not addressed here.

171. Mary J. Gregor, *Translator's Introduction* to IMMANUEL KANT, THE DOCTRINE OF VIRTUE: PART II OF THE METAPHYSICS OF MORALS, at xix (Mary J. Gregor trans., Harper & Row 1964) (1797).

172. KANT, METAPHYSICS OF MORALS, *supra* note 9 at *379-80 (stating that "the *doctrine of Right* . . . deals with duties that can be given by external laws, and . . . the *doctrine of virtue* . . . treats of duties that cannot be so given").

173. *See id.* at *220.

duties, in addition to being subject to internal constraint, also can be enforced externally, such as through the threat of sanction. All juridical duties, however, are also subject to internal enforcement if the external constraint fails and, therefore, all juridical duties are also ethical duties.[174] One is obligated to fulfill juridical duties, in other words, not only because of a possible legal sanction resulting in bad consequences, but also from the idea of duty itself.[175] If the external legal sanction were lacking, ethics steps in to require one to fulfill the duty. All duties, therefore, are duties of ethics because all can be accompanied by an ethical—inner—obligation to fulfill them.[176]

2. *Perfect and Imperfect Duties.* In addition to distinguishing juridical from ethical duties, Kant distinguished between perfect and imperfect duties. The perfect-imperfect duty distinction can be traced to Samuel Pufendorf and Hugo Grotius, and the historical background informs the application of Kant's imperfect duties to fiduciary law. In 1625, Grotius distinguished imperfect from perfect obligations. In some cases, a person may be obliged to perform a duty, but no one has a right to compel performance. Grotius called those obligations imperfect obligations. By contrast, a perfect obligation arises where one intends "to convey a peculiar right to another."[177] Similarly, in 1688, in his classic work, *On the Law of Nature and Nations*, Pufendorf discussed perfect and imperfect right, stating that one can be owed certain actions by a perfect right and others by an imperfect right. While all actions can be "voluntarily given," the difference between perfect and imperfect right is that when actions owed by a perfect right are not voluntarily given, one can resort to an action at law to force the other to provide it. By contrast, what is owed as a result of an imperfect right "cannot be . . . extorted by a threat of the law." Instead,

---

174. *See id.* at *219.

175. *See* GREGOR, *supra* note 9, at 69.

176. *See id.* at 28. A duty to repay a debt is an example. The duty is a juridical duty because the creditor can force the debtor to pay by resorting to the courts. It is also an ethical duty because absent the threat of sanction, the mere idea of duty is a reason to repay.

177. 2 HUGO GROTIUS, THE RIGHTS OF WAR AND PEACE 134 (A.C. Campbell trans., 1901).

what is owed as a result of an imperfect right is "left to a man's sense of decency and conscience."[178]

The perfect-imperfect duty distinction parallels the distinction between juridical and ethical duties.[179] In the Foundations, Kant differentiates among four types of duties: perfect and imperfect duties to oneself and perfect and imperfect duties to others.[180] Kant explains that perfect duties are narrow and unambiguous. They "permit[ ] no exception in the interest of inclination," no room for interpretation.[181] Perfect duties are generally negative—they forbid actions prohibited by Kant's Categorical Imperative. And perfect duties owed to others are juridical duties because their performance (or non-performance) can be enforced by a third party. One of Kant's examples is promising to repay a loan knowing repayment is impossible. A false promise, such as this, suffers from self-contradiction because the promissor is destroying the very institution on which he relies—promising—by using it to benefit through making a false promise.[182]

Imperfect duties are more ambiguous. If a duty does not prescribe particular actions—if it does not specify precisely how one should act—the duty is imperfect.[183] The duty of benevolence is an example; one should sacrifice a part of one's welfare for others—but it is impossible to set specific

---

178. 2 SAMUEL PUFENDORF, DE JURE NATURAE ET GENTIUM LIBRI OCTO [OF THE LAW OF NATURE AND NATIONS] 118-19 (C.H. Oldfather & W.A. Oldfather trans., Oxford University Press 1934) (1688). For an historical sketch of perfect and imperfect duty, beginning in the fourth century, see Joachim Hruschka, *Supererogation and Meritorious Duties*, 6 JAHRBUCH FÜR RECHT UND ETHIK [ANN. REV. L. ETHICS] 93 (1998) (F.R.G.).

179. In most cases, the distinction between perfect and imperfect duties depends on the distinction between juridical and ethical laws. *See* Hruschka, *supra* note 178, at 107. In some cases, however, a perfect duty is only an ethical, not a legal, duty because it may be enforced only through "inner legislation." The usual example is the duty not to commit suicide.

180. KANT, FOUNDATIONS, *supra* note 9, at *421-23.

181. *Id.* at *421 n.*; *see* Roger J. Sullivan, *The Positive Role of Prudence in the Virtuous Life*, 5 JAHRBUCH FÜR RECHT UND ETHIK [ANN. REV. L. ETHICS] 461, 464 (1997) (F.R.G.).

182. The maxim of the action cannot be universalized without completely undermining the institution of promising itself. *See* KANT, FOUNDATIONS, *supra* note 9, at *422.

183. *See* KANT, METAPHYSICS OF MORALS, *supra* note 9, at *390 (stating that such laws leave "latitude . . . for free choice").

limits on this sacrifice.[184] Imperfect duties allow for flexibility—a latitude not permitted by perfect duties. In a frequently quoted passage, Kant says: "[T]his duty is only a wide one; the duty has in it a latitude for doing more or less, and no specific limits can be assigned to what should be done."[185]

How are duties of ethics and imperfect duties related to the fiduciary obligation? As discussed, fiduciary duties, like Kant's imperfect duties, are open-ended; fiduciaries must act reasonably under the circumstances and are not expected to be right every time.[186] But the analogy to imperfect duties is deeper than the open-endedness of the obligation and goes to the core of what Kant says about duties of ethics and imperfect duties. Kant explains that perfect duties prescribe specific actions or inactions one must take. Imperfect duties prescribe adopting or embracing an end, such as the happiness of others, but not the particular actions one must take to achieve the end.[187] Thus, an imperfect duty is a duty to adopt certain aims or purposes, not to undertake particularized action.

Recognizing fiduciary duties as imperfect duties uncovers why fiduciary law has bedeviled courts and commentators for years. If the fiduciary obligation requires the fiduciary to have an end, enforcing the duty through external means would be difficult. Although Kant places great weight on the motive of one's actions,[188] no one can force another to have a motive—to have an end.[189] Adopting an end is an internal act the fiduciary must come to on his or her own. Thus, the puzzle of fiduciary law is that courts have adopted an imperfect duty as a legal standard and

---

184. *See id.* at *393.

185. *Id.* Another edition of the *Doctrine of Virtue* translated by Mary Gregor uses "the duty has in it a playroom for doing more or less." KANT, *supra* note 171, at *393.

186. *See* Clark, *supra* note 162, at 73 (describing duties as open-ended).

187. MARCIA W. BARON, KANTIAN ETHICS ALMOST WITHOUT APOLOGY 30, 42 (1995); KANT, METAPHYSICS OF MORALS, *supra* note 9 at *390.

188. KANT, METAPHYSICS OF MORALS, *supra* note 9, at *219, *375 n.*. In the context of perfecting oneself, Kant writes, "Man's greatest moral perfection is to do his duty *from duty* (for the law to be not only the rule but also the incentive of his actions)." *Id.* at *392.

189. KANT, METAPHYSICS OF MORALS, *supra* note 9, at *381.

attempt to enforce the standard through external means.[190]

Mary Gregor writes that imperfect duty consists of a "fundamental direction given to the will."[191] The fundamental direction to the will takes the form of the rule of interpretation discussed above. The direction is to interpret the principal's instructions in a manner to promote the principal's ends of which the fiduciary is or should be aware. The fundamental direction is a framework under which the fiduciary operates. It does not mandate any specific action, rather it ensures that when the fiduciary exercises discretion, it does so in accordance with

---

190. Although I do not resolve this puzzle here, perhaps one answer lies in the relationship between the fiduciary duties of loyalty and care. *See* Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U. L. REV. 75, 121-24 (2004) (discussing the difficulty of enforcing the duty of care as an imperfect duty). Under the duty of loyalty, the fiduciary must subordinate self-interest to the interest of the principal. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. a (1959) (stating that a duty of loyalty is duty not to profit at beneficiary's expense and not to enter into competition with beneficiary absent consent); RESTATEMENT (SECOND) OF AGENCY § 388 (1958) (stating that a duty of loyalty is duty not to profit on transactions conducted for principal). In that sense, the duty of loyalty is a perfect duty, which can be enforced by external means.

By contrast, the fiduciary duty of care requires the fiduciary to take positive steps to further the principal's ends. The duty of care is an instantiation of Kant's imperfect duty to adopt an end. Having a maxim of another's end requires one indirectly to perform *some* action, as explained further in the text. A fiduciary that takes no action at all is liable for breach of duty; corporate directors, for example, may not "shut their eyes" to misconduct. Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981); *see also* Bayer v. Beran, 49 N.Y.S.2d 2, 5 (1944) (explaining that the director's honesty is not sufficient, the director "may not act as a dummy or a figurehead. He is called upon to use care, to exercise judgment").

The subsidiary duties of loyalty and care, therefore, form a potent cocktail to enforce the fiduciary obligation as an imperfect duty. Courts require some (unspecified) positive acts under the rubric of the duty of care. At the same time, courts require that action taken not result in either a benefit to the fiduciary or harm to the principal. Prophylactic rules against negative conduct help ensure that any act the fiduciary undertakes is performed to benefit the principal as opposed to fulfilling selfish desires. The trustee, for example, must take some positive steps to manage the trust account, but any action taken must benefit only the beneficiaries, not the trustee. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); *see also Francis*, 432 A.2d at 821 (stating that specific duties depend on generalized standard of ordinary care). Although a court cannot require a fiduciary to have an end, it can examine how one would act if he or she had adopted an end and, as a result, imperfect duties to the principal effectively can be enforced externally.

191. GREGOR, *supra* note 9, at 90; *see also id.* at 23.

the principal's ends.

Fiduciary law is consistent with the search for whether fiduciaries are motivated to act in the principal's interest or whether the fiduciary has some other end in mind. A good example is *Shlensky v. Wrigley*,[192] a leading case governing corporate fiduciaries. Philip K. Wrigley, owner of the Chicago Cubs, famously refused to institute night baseball at Wrigley Field in the 1960s. The plaintiff, who owned stock in the corporation that owned and operated the Cubs brought suit alleging that without night games, losses would continue to mount.[193] The defendants claimed they were protected by the business judgment rule, which shields directors' business decisions unless tainted by fraud, illegality, or a conflict of interest.[194]

In deciding whether the business judgment rule applied, the court was forced to assess Wrigley's motives. Was he out for the corporation or was he out for himself? If the latter were the case, Wrigley would have a conflict of interest with the shareholders and the business judgment rule would not protect him. The court ruled for Wrigley because it was unconvinced that his alleged motives were contrary to the best interests of the corporation and the shareholders. The court explained that the decision to forgo night games could be justified to ensure the safety of patrons visiting the ballpark or to keep the neighborhood from deteriorating, not inconsistent with the company's well-being.[195] The court even suggested it might disagree with the board's decision, but disagreement with the board is irrelevant absent the board's improper motives.

Recent cases in the area of directors' duties emphasize the proper motives under which directors must carry out their responsibilities. In the closely watched *Disney* case, the Delaware Supreme Court held that the Disney directors did not breach their fiduciary duties in the handling of the hiring and termination of Michael Ovitz.[196] The court restated the conventional presumption that directors of a

192. 237 N.E.2d 776 (Ill. App. Ct. 1968).

193. *Id.* at 777.

194. *Id.* at 778.

195. *Id.* at 780.

196. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).

corporation, in making business decisions, act in the "'honest belief that the action taken was in the best interests of the company.'"[197] Note that this formulation is not a presumption that the action was in the best interest of the corporation, but rather that the directors honestly believe that the action was in the best interest of the corporation. The emphasis is on the directors' belief. What were they thinking when the action occurred? As another court put it, the directors' actions are presumed to be "'inspired for the best interest[ ] of the corporation.'"[198]

A duty to adopt an end does not mean that no action is required; it does not mean that aspiring to promote the principal's end is sufficient to uphold one's duty. Some commenters have suggested that the fiduciary duty is merely aspirational.[199] In *The Motive, Not the Deed*, Lionel Smith argues that the essence of the fiduciary duty lies in the "justiciability of motive."[200] Although motive plays a key role, it is not the only relevant consideration. Some concrete action is required—ends imply action—although, as with all imperfect duties, the fiduciary cannot specify the precise action to be done. In *The Metaphysics of Morals*, Kant defines an end as "an object of free choice" the thought of which determines one's choice to take an action by which the object will be brought about.[201] There is an "intrinsic connection" between ends and human action.[202] Imperfect duties and obedience to ethical laws require some external conduct insofar as the adoption of an end implies that some action must be taken toward that end.[203] "[T]he adoption of an end is not merely an idle wish. It must manifest itself in

---

197. *Id.* at 52 (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

198. Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971) (quoting Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966)).

199. *See* Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 648 (2004) ("[F]iduciary duty of care, if not ephemeral, exists only as an aspirational and unenforceable standard."); Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1696 (1990) ("[L]anguage expressing [fiduciary] norms is aspirational and studiously imprecise.").

200. Smith, *supra* note 133, at 64.

201. KANT, METAPHYSICS OF MORALS, *supra* note 9, at *384-85; *see also* GREGOR, *supra* note 9, at 86.

202. GREGOR, *supra* note 9, at 86.

203. *Id.* at 23.

action toward the end . . . ."[204]

According to Kant, ethics refers to maxims, and only "indirectly and mediately" to our actions. It is left to our judgment to decide how we will observe an ethical law.[205] "[W]e need not always be acting toward these specific obligatory ends; we fulfil [sic] our duty in this regard by having maxims of promoting these ends—maxims which, as the circumstances arise, will be translated into action."[206] Smith, therefore, stops short of what the fiduciary obligation requires when he says the fiduciary obligation "never obliges the fiduciary to act or not to act."[207]

Adoption of the principal's objectives or ends, joined with the absence of a particular formula for achieving those ends, is the animating principle of fiduciary law. As one court put it:

> [T]hose [fiduciary] platitudes express something deeper; they are a judicial attempt to emphasize that the heart of a corporate fiduciary's duty is an attitude, not a rule. The fiduciary best fulfills its duties if it approaches them with the attitude of seeking the beneficiary's interests rather than the personal interests of the fiduciary, not if it simply tries to follow rules codified from past decisions.[208]

Leading fiduciary cases employ the language of the adoption of the principal's ends. Although the fiduciary may have discretion in the methods used to further the principal's objectives, the fiduciary cannot lose sight of the principal's goals. In *Dodge v. Ford Motor Co.*, in applying the business judgment rule, the court overturned Henry Ford's decision to withhold a special dividend because his objective in withholding the dividend was not to maximize profits but rather to raise salaries and lower prices.[209] The

---

204. *Id.* at 103.

205. *Id.* at 98.

206. *Id.* at 90; *see also* Marcia Baron, *Imperfect Duties and Supererogatory Acts*, 6 JAHRBUCH FÜR RECHT UND ETHIK [ANN. REV. L. ETHICS] 57, 59 n.8 (1998) (F.R.G.) (arguing that imperfect duty is obligatory only at an abstract level, but each instantiation of the duty is not obligatory).

207. Smith, *supra* note 133, at 77.

208. Chiles v. Robertson, 767 P.2d 903, 911-12 (Or. Ct. App. 1989).

209. Dodge v. Ford Motor Co., 170 N.W. 668, 683-84 (Mich. 1919) ("His testimony creates the impression, also, that he thinks the Ford Motor Company

Michigan Supreme Court stated:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself . . . .[210]

This is consistent with Kant's imperfect duties. The directors must adopt the shareholders' end—profit—which is the reason the business is organized in the first place.[211] The directors then have latitude in how to achieve that end. Courts suggest methods by which a board can fulfill its obligation, but state there is "no single blueprint" to be followed.[212] The directors, however, cannot change the end

---

has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public . . . ought to be undertaken."). The irony of the case is that Ford arguably had a strategic business purpose in mind. The Dodge brothers, who owned 10 percent of Ford, were planning to start their own company and Ford could have been looking for ways to foil their plan. Commentators note that withholding the dividend would cut off one source of financing for the Dodge brothers, or weaken their financial position so that Ford could buy them out in the future, which he subsequently did. *See, e.g.*, ROBERT CHARLES CLARK, CORPORATE LAW 604 (1986) ("Many . . . have wondered whether Ford's 'eleemosynary' explanation of the cessation of special dividends was genuine."); D.A. Jeremy Telman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 TUL. L. REV. 829, 867-68 (2007) ("Henry Ford understood that he could not testify truthfully about his reasons for not issuing a large dividend to Ford's shareholders without revealing prospective business plans and his concerns regarding the threat of competition from the Dodge brothers . . . ."). The court, however, took Ford at his word and since he said he was pursuing a different end than shareholder profits, the court ruled against him.

210. *Id.* at 684; *see also* Corrado Bros. v. Twin City Fire Ins. Co., 562 A.2d 1188, 1192 (Del. 1989) (stating that interests of fiduciary and principal "incline toward a common goal").

211. *See* ROBERT C. CLARK, CORPORATE LAW 678 (1986) (discussing conventional view that directors and officers have a fiduciary duty to maximize shareholder wealth). This claim is controversial. *See* Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, at 3 (UCLA Sch. of Law, Law & Econ. Research Paper Series, Research Paper No. 07-11), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1013744 (arguing *Dodge v. Ford* is bad law when cited for the proposition that the corporate purpose is maximizing shareholder wealth). *But see* Paramount Commun. Inc. v. QVC Network, 637 A.2d 34, 44 (Del. 1994) (in sale of control context, directors must focus on obtaining best value for stockholders "and they must exercise their fiduciary duties to further that end").

212. *Paramount*, 637 A.2d at 44 (quoting Barkan v. Amsted Indus., Inc., 567

itself. Their flexibility is only appropriate insofar as they exercise it in the choice of means to achieve the obligatory end.

Dodge v. Ford is also consistent with Kant's view on how it is possible to *violate* an imperfect duty. Since an imperfect duty consists of adopting an end, a violation of an imperfect duty must parallel the duty itself—the violation must consist of adopting an end indifferent to, or in opposition to, the obligatory end.[213] In *Dodge v. Ford*, the plaintiffs prevailed on one claim because they could show Ford adopted a maxim of indifference toward the corporation and its shareholders. Ford may have been concerned with employees or consumers, but he was indifferent to the shareholders' ends.

III. ADOPTION OF ENDS IN FIDUCIARY LAW

Contractual scholars analyzing fiduciary cases try to explain them through contractual methods. Part I demonstrated that the contractual approach has limitations; Part II put forth an alternative explanation based on the duty to adopt the principal's objectives or ends; this Part shows that leading fiduciary cases can be better explained through viewing the fiduciary duty in this way. In fiduciary cases, courts are concerned with how a fiduciary would behave if he adopted the principal's ends. Viewing the fiduciary duty through this lens better explains leading cases in the fiduciary area. In addition, Part I explained that the contractual account is both over- and under-inclusive and, therefore, not a robust descriptive theory of the fiduciary relationship. I used examples such as lawyers, auditors, stockbrokers, and investment advisors for support. Later in this Part, I revisit those examples and show how my account of the fiduciary relationship better explains rules distinguishing fiduciaries from non-fiduciaries.

A.2d 1279, 1286-87 (Del. Super. Ct. 1989)).

213. *See* GREGOR, *supra* note 9, at 100.

A. Meinhard v. Salmon[214]

One of the lingering questions presented by *Meinhard* is whether Salmon could have satisfied Cardozo merely by disclosing the new opportunity presented by Gerry.[215] Cardozo seems most troubled by Salmon's failure to disclose the opportunity because silence precluded Meinhard from any chance to compete.[216] One view of the case is that disclosure, which is really all Cardozo was looking for, is consistent with a contractual approach because disclosure would have allowed both parties to bid for the asset, which would have wound up in the hands of the coadventurer who valued it most.[217]

Disclosure in this case, however, can better be viewed as a condition to Salmon's adopting Meinhard's ends. Disclosure goes beyond what contracting parties at arm's length could demand of one another. Absent the fiduciary relationship, Salmon may have been justified in remaining silent about the new lease. Cardozo's required disclosure is not what one would expect in the case of most contracting parties because such parties may stay silent.[218] The duty of disclosure goes beyond what a contractual approach would call for. Salmon's disclosure to Meinhard would promote Meinhard's ends because disclosure would have allowed Meinhard to evaluate Salmon's own goals or objectives to

---

214. 164 N.E. 545 (N.Y. 1928).

215. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 439.

216. *Meinhard*, 164 N.E. at 547 ("He might have warned Meinhard that the plan had been submitted, and that either would be free to compete for the award. . . . The trouble about [Salmon's] conduct is that he excluded his coadventurer from any chance to compete . . . ."); *id.* at 548 ("A managing coadventurer appropriating the benefit of such a lease without warning to his partner might fairly expect to be reproached with conduct that was underhand, or lacking, to say the least, in reasonable candor . . . .").

217. *See* Easterbrook & Fischel, *Contract*, *supra* note 1, at 440 ("Cardozo conjectures that Meinhard would have bought an interest or made a better bid . . . .").

218. *See* Libby v. L. J. Corp., 247 F.2d 78, 82 (D.C. Cir. 1957) ("This fiduciary relationship precludes one member of the venture from purchasing or otherwise dealing with the property involved in the venture without a full disclosure to his associates. . . . Where one of the members acts as 'captain' or 'manager' of the venture the necessity for a full disclosure becomes more acute and rests more heavily on him.").

ensure they are consistent with Meinhard's.[219] If a principal determines a fiduciary no longer has the principal's interests in mind, the principal may terminate or renegotiate the relationship.

Moreover, in some passages, Cardozo strongly suggested that disclosure would not have sufficed. "Not honesty alone" is the standard of behavior for Salmon, implying that Salmon had to do more than merely disclose the opportunity to Meinhard.[220] Cardozo writes that Salmon had to renounce "thought of self . . . however hard the abnegation."[221] Cardozo's canonical text that honesty itself is not sufficient suggests that Salmon had to allow Meinhard to participate in the new lease transaction; he had to include Meinhard in the arrangement regardless of disclosure.[222]

Finally, the remedy Cardozo imposes is that of constructive trust.[223] The remedy is significant because a constructive trust, unlike an express trust, is a judicially crafted remedy based not on the intentions of the parties, but rather on the argument that the person holding title to property would profit by a wrong or be unjustly enriched if permitted to keep it.[224] Cardozo wrote that a constructive trust is a remedial device through which one places the interests of others before one's self-interest.[225] Thus, Cardozo's remedy is one where Salmon must adopt Meinhard's ends as opposed to his own.

---

219. Mitchell, *supra* note 124, at 193 ("[W]e create disclosure requirements so that persons dependent upon corporate fiduciaries can evaluate their goals and monitor their activities.").

220. *Meinhard*, 164 N.E. at 546.

221. *Id.* at 548.

222. *Id.* at 546; *see* Barry E. Adler, *The Accidental Agent*, 2005 U. ILL. L. REV. 65, 67 (stating that *Meinhard* stands for proposition that valuable opportunity is a profit partners agreed to share); Claire Moore Dickerson, *Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 417, 428 n.42 (1995).

223. *Meinhard*, 164 N.E. at 548.

224. RESTATEMENT (FIRST) OF RESTITUTION § 160 cmt. a, b (1937).

225. *Meinhard*, 164 N.E. at 548 ("A constructive trust is, then, the remedial device through which preference of self is made subordinate to loyalty to others.").

B. Firestone Tire & Rubber Co. v. Bruch[226]

Firestone also demonstrates the emphasis on the requirement of a fiduciary to adopt the principal's ends. In *Firestone*, six Firestone employees sought severance benefits from Firestone when Firestone sold five plants to Occidental Petroleum Company and the employees were denied benefits under a termination pay plan. The plan entitled the employees to benefits if their service was discontinued due to a reduction in work force. The employees were rehired by Occidental and Firestone claimed no such reduction had occurred. The District Court granted Firestone's motion for summary judgment using an arbitrary and capricious standard of review.[227] The Court of Appeals reversed, and the U.S. Supreme Court granted certiorari to address the proper standard of review in actions challenging the denial of benefits based on plan interpretations.[228]

In determining the appropriate standard of review, the Court rejected the arbitrary and capricious standard developed under the Labor Management Relations Act (LMRA).[229] The Court began by explaining that ERISA is drawn from the law of trusts, which guides the Court in determining the appropriate standard of review. According to trust principles, a deferential standard of review—such as arbitrary and capricious—is appropriate only when a trustee has been given discretionary powers.[230] Whether the trustee has been given discretionary powers turns on the trust instrument. In *Firestone*, there is no evidence that the plan administrator has the power to construe terms or that determinations of eligibility should be given deference.[231]

---

226. 489 U.S. 101 (1989).

227. *Id.* at 106-07.

228. *Id.* at 108.

229. The Court refused to import the arbitrary and capricious standard derived from the LMRA because courts adopted the arbitrary and capricious standard there primarily as a means to assert jurisdiction over certain suits brought by beneficiaries of LMRA plans, who were denied benefits. Since ERISA expressly authorized suits against fiduciaries and plan administrators to remedy statutory and fiduciary breaches, the reason for the LMRA arbitrary and capricious standard is not applicable in ERISA. *Id.* at 110.

230. *Id.* at 111.

231. Firestone argued that ERISA defines a fiduciary as one who exercises

The Court fell back on a *de novo* standard of review. In making that decision, however, the Court highlighted that ERISA was enacted to further the interests of employees and their beneficiaries in employee benefit plans.[232] Adopting Firestone's view would leave employees and their beneficiaries with less protection than they had before ERISA was passed.[233] In order to promote the employees' ends, therefore, the Court adopted a standard of review that leaves employees better off than they were before ERISA's enactment. Absent discretionary language in the plan documents, the *de novo* standard of review is one way to help ensure that plan fiduciaries further their principals' interests and promote their ends.

One could argue that *Firestone* suggests that ERISA law is negotiable based on the ability to vary the standard of review by altering the discretion given the plan administrator. First, as pointed out above, the ability to vary the standard of review by changing the discretion granted to the plan administrator is not tantamount to making most or all of ERISA law contractual. The statute has a strong anti-contractual tilt, providing that "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries . . . ."[234] As discussed, an ERISA fiduciary must discharge his duties "solely in the interest" of plan participants and beneficiaries.[235]

Moreover, if the plan documents—and most do—give the plan administrator broad discretion to exercise its powers, and the administrator adopts the employees' ends

---

any discretionary authority or discretionary control with respect to the management of a plan. Since Firestone exercised discretion and owed fiduciary duties, it should be entitled to the deferential standard of review. The Court did not buy that argument. The Court drew a distinction between the power to exercise *all* of one's authority in a discretionary manner and the power to exercise *any* discretionary authority. And it is the latter which satisfies the definition of "fiduciary" under ERISA. Firestone could show that it exercised some fiduciary power, not that all of its power was discretionary. *Id.* at 113.

232. *Id.*

233. *Id.* at 113-14.

234. Employee Retirement Income Security Act of 1974, § 403(c)(1), 29 U.S.C. § 1103(c)(1) (2006).

235. Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) (quoting ERISA § 404(a)).

as its own, just like with the business judgment rule in corporate law, the courts are loathe to second guess the means that the plan administrator uses to accomplish those ends. This is consistent with the description of imperfect duties provided in Part II. Once the court is convinced that the plan administrator has adopted the employees' ends, the administrator has wide latitude in the means it uses to accomplish the end.

Courts, however, become concerned when there is a hint that the agent has not adopted the principal's ends. One scenario when that occurs is when the fiduciary has a conflict of interest, because, by definition, a conflict of interest suggests the fiduciary has his own interests (or the interests of others) in mind and not the principal's interests. It is precisely in that case, according to *Firestone*, that even if an arbitrary and capricious standard of review were applicable, the conflict bears upon whether an abuse of discretion has occurred.[236]

Decisions post-*Firestone* are consistent with a requirement of an ERISA fiduciary to adopt the ends of plan participants. Under *Firestone*, a conflict results in a less deferential standard of review.[237] Courts worry about conflicts of interest because it is in those cases that the fiduciary is less likely to adopt the ends of the plan participants and pursue its own ends instead. In conflict situations, some courts adopt a sliding scale approach with respect to the standard of review: the worse the conflict, the less deference the fiduciary receives.[238]

Other courts use a burden-shifting approach. The court determines *de novo* if the decision was wrong. If it was wrong, and if a conflict exists, the burden shifts to the administrator.[239] An example is *Brown v. Blue Cross & Blue*

---

236. *Firestone*, 489 U.S. at 115 (citing RESTATEMENT (SECOND) OF TRUSTS § 187, cmt. d (1959)). The significance of the conflict on judicial review will likely be addressed by the Supreme Court soon. *See supra* note 94.

237. *See supra* notes 92-94 and accompanying text.

238. *See, e.g.*, Fought v. Unum Life Ins. Co. of Am., 379 F.3d 997, 1004 (10th Cir. 2004) (per curiam) (decreasing deference given to administrator's decision in proportion to gravity of the conflict); Woo v. Deluxe Corp., 144 F.3d 1157, 1161-62 & n.2 (8th Cir. 1998) (adopting sliding scale standard of review).

239. *See, e.g.*, HCA Health Servs., Inc. v. Employers Health Ins. Co., 240 F.3d 982, 993-94 (11th Cir. 2001) (shifting burden to administrator to prove its interpretation was not in self-interest).

Shield.[240] In that case, an insurance company was the decision-maker for benefits to be paid out of the insurance company's assets and, therefore, its fiduciary role was in "perpetual conflict" with its bottom line.[241] The court held that although the arbitrary and capricious standard was applicable, the application of that standard would vary depending on the gravity of the conflict.[242] If the conflict is substantial, the burden shifts to the fiduciary to prove its interpretation of the plan was not motivated by self-interest.[243] Thus, although a plan fiduciary can operate under a conflict of interest, the conflict triggers a new rule that the area of discretion subject to a deferential standard of review will be limited to decisions where the fiduciary can show it operated "exclusively in the interests of the plan participants and beneficiaries."[244] Once again, the court adopted the language of pursuing the principal's ends to clarify its position. Even a very broad delegation of discretion to a fiduciary is "bounded by the limitation that the fiduciary cannot act from a motive other than the accomplishment of the purposes of the trust."[245] This is the language of ends.

C. *The Business Judgment Rule in Corporate Law*

Understanding the fiduciary duty as a duty to adopt the principal's ends also helps explain the business judgment rule, a central feature of corporate law. The business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[246] There are several explanations for the business judgment rule. One is that courts are not business experts and lack the awareness of the range of factors that go into business

240. 898 F.2d 1556 (11th Cir. 1990).

241. *Id.* at 1561.

242. *Id.* at 1563-64.

243. *Id.* at 1566.

244. *Id.* at 1568.

245. *Id.* at 1566.

246. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see* BAINBRIDGE, *supra* note 27, at 241-42.

decisions.[247] That explanation, however, is inadequate because courts do not shy from making "expert" decisions in other contexts and, occasionally, in business law cases.[248] Another explanation is that judicial controls on board behavior merely duplicate market controls and are therefore unnecessary. There is no reason to believe, however, that duplicate controls are not useful particularly when markets fail.[249] A third explanation is the business judgment rule serves to bolster the board's authority to take risks.[250] That too is incomplete because the business judgment rule also protects board decisions that are overly conservative.[251]

A better explanation of the business judgment rule is that it permits the board to adopt an end—corporate profits—and then provides great flexibility or discretion to achieve that end. As discussed, when a court applies the business judgment rule, it gives wide latitude to officers and directors to obtain the corporation's goals, as opposed to substituting the court's judgment of what constitutes sound business judgment.[252] Consider when the business judgment rule does *not* apply, namely when directors fail to adopt the shareholders' ends. The business judgment rule is inapplicable if the directors' decision was not the result of deliberations by an informed and independent board.[253] If the board is not independent, if it has its own interests in mind and not shareholders' interests, the board has failed

---

247. *See* BAINBRIDGE, *supra* note 27, at 254; Paula J. Dalley, *The Business Judgment Rule: What You Thought You Knew*, 60 CONSUMER FIN. L.Q. REP. 24, 25 (2006).

248. *See, e.g.*, Zapata v. Maldonado, 430 A.2d 779, 789 (Del. 1981) (where demand is excused, court will apply "its own independent business judgment" in determining whether corporation's motion to dismiss should be granted); *see also* BAINBRIDGE, *supra* note 27, at 254 ("[B]usiness law is not the only context in which judges are called upon to review complex issues arising under conditions of uncertainty . . . [y]et, no 'medical judgment' or 'design judgment' rule precludes judicial review of malpractice or product liability cases.").

249. *See* Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1073-74 (1993).

250. *See* BAINBRIDGE, *supra* note 27, at 259; Dalley, *supra* note 247, at 25.

251. BAINBRIDGE, *supra* note 27, at 263.

252. *See supra* notes 209-10 and accompanying text.

253. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988).

to make the shareholders' ends the board's ends and the board loses the benefit of the business judgment rule.

Clarifying when a corporate board has the benefit of the business judgment rule is one lesson of the *Disney* case.[254] In *Disney*, the board did not lose the benefit of the business judgment rule because the plaintiffs were unable to show that the board did not act with due care and in good faith.[255] The court discussed three possible categories of fiduciary behavior that could potentially be bad faith conduct, and therefore not subject to the business judgment rule. One can understand the court's determinations with respect to each category by viewing the relevant behavior in the context of the adoption of the shareholders' ends.

The first category of bad faith conduct is subjective bad faith where the fiduciary intends harm.[256] In the case of subjective bad faith, the fiduciary purposefully rejects the principal's ends and works affirmatively against them. There is no question that such conduct is in bad faith and results in loss of the business judgment rule.[257]

The second category comprises actions taken without due care—actions reflecting gross negligence, but with no evil intent.[258] The court stated that such conduct would not result in bad faith because the duty of care and the duty to act in good faith are distinct.[259] This is consistent with my thesis. Negligent, even grossly negligent, conduct does not mean that the fiduciary has rejected the principal's ends. Although negligent conduct is not consistent with fulfilling the fiduciary obligation because the fiduciary has failed to *further* the principal's ends, it does not constitute a *rejection* of the ends. In that regard, such conduct would not result in bad faith and the business judgment rule would apply.

The third category, which falls between the first two, is "intentional dereliction of duty, a conscious disregard for one's responsibilities."[260] This conduct is not disloyal in the

254. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).

255. *Id.* at 64-68.

256. *Id.* at 64.

257. *See id.*

258. *Id.*

259. *Id.* at 65.

260. *Id.* at 66.

classic sense of preferring oneself over others, but it is worse than mere "inattention or failure to be informed."[261] Some mechanism, the court said, is needed to address this in-between conduct, and good faith is the answer. There is a deeper reason, however, why such conduct would be considered bad faith and the business judgment rule would not apply. Look at the language of the Delaware Supreme Court, quoting the Chancery Court:

> The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, in the narrow sense that I have discussed them above, but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders. A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.[262]

This passage is important for two reasons. First, it highlights the court's emphasis on devotion to the principal's ends. Second, it articulates a standard of bad faith that rests on *intentionality*—failing to pursue the principal's ends either by pursuing some other end instead or by failing to pursue the principal's end when the fiduciary knows it has a duty to do so.

D. *Insider Trading*

Another area of controversy is the law of insider trading, which also supports my approach. Insider trading cases, even those cited by contractual scholars, reject the methods of contract and adopt a duty-based analysis.[263]

---

261. *Id.*

262. *Id.* at 67 (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005) (citations omitted)). A second reason, according to the court, why this conduct would be treated as a violation of good faith is because section 102(b)(7)(ii) distinguishes between intentional misconduct and acts not in good faith. Because section 102(b)(7)(ii) only exculpates gross negligence, the legislature's decision not to exculpate acts not in good faith must mean that acts not in good faith are worse than intentional acts but not as bad as gross negligence. *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 67.

263. *See, e.g.*, United States v. Chestman, 947 F.2d 551 (2d Cir. 1991),

United States v. Chestman is an example.[264] Robert Chestman was a stockbroker for Keith Loeb. Keith was married to Susan Loeb, the granddaughter of Julia Waldbaum, an insider of Waldbaum, Inc., the supermarket chain. Keith learned from his wife Susan that Waldbaum was likely to be sold at a premium to The Great Atlantic and Pacific Tea Company, and Keith shared this information with Robert. Robert then purchased Waldbaum shares for himself and his clients, including Keith, and the Securities and Exchange Commission and the criminal authorities sued Keith and Robert for insider trading. Although Keith settled the charges against him, Robert litigated and was convicted for insider trading based on the underlying fact that Keith owed a duty to the Waldbaum family "based on a fiduciary or similar relationship of trust and confidence."[265] Much of the case, therefore, turns on whether Keith owed a fiduciary duty to Susan and the Waldbaum family when he disclosed the information to Robert.[266]

On appeal, the court determined that Keith owed a fiduciary duty to neither Susan nor the Waldbaums. Ironically, it is the reversal of Chestman's conviction for insider trading that demonstrates the fiduciary relationship as the adoption of ends as opposed to a contractual approach. For Chestman's conviction to be upheld, the government had to show that Keith owed a fiduciary duty or similar duty of trust and confidence to Susan or the Waldbaums.[267] If fiduciary duties were comprised of duties implied by contract, then such duties would have existed on Keith's part: Both the majority and the dissent state that

---

referenced in Easterbrook & Fischel, *Contract*, *supra* note 1, at 440 n.36.

264. *Chestman* is an interesting opinion to examine for several reasons. First, it is the result of a rehearing *en banc* with the participation of twelve judges. Second, the opinion contains a long discussion of the nature of the fiduciary relationship and fiduciary duties, and the court even states it "must ascertain the characteristics of a fiduciary relationship." *Chestman*, 947 F.2d at 567-68. Finally, the decision includes a lengthy dissent, spelling out a different approach to the problem.

265. *Id.* at 564.

266. *See id.* at 570 (explaining that this is the government's theory of the case).

267. *See id.* at 568 (explaining that under the misappropriation theory, there must be a fiduciary relationship or similar relationship of trust and confidence, and that determination requires ascertaining characteristics of fiduciary relationship).

there was at least an implied agreement for Keith not to share with anyone the information he obtained from Susan.[268]

The majority, however, does not decide the case on implied contract grounds. Although the majority agrees that one can at times imply a term of confidentiality, that implication must be *based* on something—something more is required for implication to occur, namely a preexisting fiduciary relationship between the parties.[269] There is a difference, therefore, between implied terms and fiduciary duties because implied terms are only implied if the underlying fiduciary relationship can be established.[270]

The preexisting relation, according to the court, comes about when one person relies on another to serve the interests of the first.[271] The fiduciary in other words must further (or serve) the interests or ends of the principal. Once that relationship is established, it is possible to claim the fiduciary received information for the purpose of benefiting the principal. At that point, the fiduciary has a duty not to disclose the information to anyone else. The implied term, however, can only come about after the underlying duty to adopt the ends of another has been established.

In *Chestman*, it is the dissent that leans toward a contractual approach, which does not carry the day. The dissent would hold Robert liable for insider trading based on a fiduciary duty owed by Keith to Susan—a quasi-contractual duty. Keith's duty according to the dissent is based on a mutual agreement among family members that information of the type here cannot be shared with

---

268. *Id.* at 571 (explaining that evidence in the case showed past history of sharing confidential information); *see also id.* at 579 (Winter, J., dissenting) (stating that Susan stressed need for secrecy and they respected one another's confidences in the past).

269. *Id.* at 571 (majority opinion) ("While acceptance may be implied, it must be implied from a pre-existing fiduciary-like relationship between the parties.").

270. *Id.* ("Keith's status as Susan's husband could not itself establish fiduciary status. Nor, absent a pre-existing fiduciary relation or an express agreement of confidentiality, could the coda—'Don't tell.'").

271. *Id.* at 569 ("A fiduciary relationship involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests.").

outsiders.[272] By sharing the information with Robert, Keith breached the express or implied terms of an agreement with Susan and the family. Robert knew of this breach and his conviction, according to the dissent, should be affirmed. The contractual approach, however, did not persuade the majority in *Chestman*.

Contractualists maintain that insider trading cases rely on contractual methods, such as imputation of terms in deciding who can trade. In *Carpenter v. United States*, for example, the U.S. Supreme Court upheld the conviction of R. Foster Winans, who wrote the "Heard on the Street" column for the *Wall Street Journal*, and gave advance information about the timing and contents of the column to employees at Kidder Peabody.[273] The opinion discusses confidential information as a "species of property" as well as the *Journal*'s right in keeping confidential the contents of the column.[274] The claim is that whether one has a duty not to trade is governed by who owns the information, which is property.

These cases, however, do not turn on who is the rightful owner of property. Rather courts perform a duty analysis based on the nature of the relationship between the parties. The duty analysis does not depend on contract, it is prior to a contract. In *Carpenter*, like in *Chestman*, the prohibition on exploiting information arises as a result of receiving information after a fiduciary relationship has been established.[275] The requirement to keep the information confidential, therefore, is not tantamount to the fiduciary obligation; the duty of confidentiality is not a fiduciary term. Rather, the duty to keep the company's information confidential arises from a preexisting fiduciary relationship.

Earlier, in *Chiarella v. United States*, the Court overturned the conviction of a financial printer, who was

---

272. *Id.* at 579 (Winter, J., dissenting) ("Such a duty is of course based on mutual understandings among family members—quite explicit in this case—and owed to the family.").

273. Carpenter v. United States, 484 U.S. 19 (1987).

274. *See id.* at 26.

275. *Id.* at 27-28 ("'[A] person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge . . . .'" (quoting Diamond v. Oreamuno, 248 N.E.2d 910, 912 (1969))).

able in advance of the final printing date to decipher information about corporate takeover bids.[276] The Court discussed the duty to disclose and stated that it arose "from a relationship of trust and confidence between [the] parties to a transaction."[277] In discussing the source of the duty to disclose, the Court stated that it is applicable to corporate insiders who have an obligation to place the interests of shareholders before their own interests. Thus, the Court first looked to when one party adopts the ends of another. In those relationships—fiduciary relationships—the obligation to maintain confidentiality arises. Echoing this theme, Lawrence Mitchell has explained that adopting the client's ends is prior to the principal's willingness to repose trust in the fiduciary.[278] In *Chiarella*, the printer did not owe fiduciary duties to those with whom he traded and his conviction, therefore, was reversed.[279]

E. *Distinguishing Fiduciary from Non-Fiduciary Relationships*

Viewing the fiduciary obligation as a duty to adopt the principal's ends helps explain which relationships are fiduciary relationships and which are not. Recall the examples discussed above to demonstrate that the contractual approach is both over- and under-inclusive. Lawyers are fiduciaries, but not auditors;[280] investment advisors and financial planners are fiduciaries but not stockbrokers.[281]

---

276. Chiarella v. United States, 445 U.S. 222 (1980).

277. *Id.* at 230, *quoted in* United States v. O'Hagan, 521 U.S. 642, 662 (1997).

278. *See* Mitchell, *supra* note 124, at 193 (circumstances for reposing trust in fiduciary exist when "fiduciary demonstrates that she understands the beneficiary's goals, and that she intends to act, and does act, in furtherance of those goals"); *see also Developments in the Law: Conflicts of Interest in the Legal Profession*, 94 HARV. L. REV. 1244, 1265 n.66 (1981) (stating that the fiduciary model ensures the lawyer, as a fiduciary, will adopt "concrete moral ends" of client).

279. *Chiarella*, 445 U.S. at 232-33.

280. *See* cases cited *supra* note 47. *See generally* Arthur B. Laby, *Differentiating Gatekeepers*, 1 BROOK. J. CORP., FIN. & COM. L. 119 (2006) (comparing and contrasting gatekeepers, such as lawyers and auditors).

281. *See* cases cited *supra* note 43; *see also* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963) ("The Investment Advisers Act of 1940 thus reflects a congressional recognition 'of the delicate fiduciary nature of an

Contractualists point to high costs of contract specification and monitoring to explain when fiduciary duties arise. Auditors and stockbrokers, and their customers, however, are subject to the same high contracting costs as lawyers and financial advisors, and their clients, yet auditors and stockbrokers typically are not fiduciaries. Why not?

Let us again look at auditors. A business engages an auditor to objectively evaluate a company's books and report the results. The auditor is a check on management. It does not stand in the shoes of the client or represent the client in any respect—it lacks all indicia of the role identification discussed above.[282] Indeed fiduciary norms are anathema to the notion of an independent audit.[283] Auditors are discouraged from developing a long-term relationship with an audit client, which can jeopardize an auditor's independence. Securities and Exchange Commission rules provide that audit partners must "rotate off" an engagement after no more than seven years—a rule designed to terminate the relationship before it grows into one where independence might be compromised.[284] The auditor's duty, therefore, cannot be described as an imperfect duty—it does not and cannot adopt the client's ends as its own.[285] Indeed, if the auditor were to adopt the

---

investment advisory relationship' . . . .").

282. *See supra* notes 141-44 and accompanying text.

283. Auditors, particularly those auditing the books of a public company, owe fidelity to the public, not the client. In the *Arthur Young* case, the Supreme Court noted that by "certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client." United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984).

284. Strengthening the Commission's Requirements Regarding Auditor Independence, Securities Act Release No. 8183, Exchange Act Release No. 47,265, Investment Company Act Release No. 25,915, 68 Fed. Reg. 6006, 6038 (Feb. 5, 2003) (to be codified at 17 C.F.R. pts. 210, 240, 249, 274) (explaining that, under new SEC rules, no audit partner can serve on an engagement team for more than seven consecutive years and lead and concurring partners can serve no more than five).

285. Although typically not fiduciaries, courts sometimes impose fiduciary duties on auditors and accountants based on factors exogenous to their contract for services, such as where a relationship of trust and confidence is established or if the auditor provides advice. *See, e.g.*, Burdett v. Miller, 957 F.2d 1375, 1381-82 (7th Cir. 1992) (accountant cultivated relationship of trust with client and held himself out as expert investor, on which client relied). In *In re Cendant Corp. Securities Litigation*, the court analyzed whether Cendant's auditor,

client's ends, it would likely impair its independence with respect to the client and be prohibited from auditing the firm's financial statements.

Contrast auditors with lawyers, who are prototypical fiduciaries. Lawyers provide a different service than auditors; their fidelity is primarily to the client, not the public. In the Anglo-American system, lawyers are not meant to be impartial—they are meant to advance the client's interests.[286] The lawyer's service is to guide the client's affairs and achieve the clients' objectives within the bounds of the law, which is often designed to cabin those very objectives.[287] As discussed above, lawyers identify closely with their clients. Gerald Postema has explained that at the client's behest, the lawyer becomes an "extension" of the legal and moral personality of the client.[288] Most Anglo-American lawyers learn about the

---

Ernst & Young, was a fiduciary to Cendant in the conduct of the audit. *In re* Cedant Corp. Sec. Litig., 139 F. Supp. 2d 585, 608-09 (D.N.J. 2001). The court explained that the auditor-client relationship is generally not a fiduciary relationship. *Id.* at 609. Where the relationship goes beyond an independent audit and extends to providing advice, however, a fiduciary relationship may exist. *See id.* The difference, of course, is that advice is meant to further the client's ends, not merely provide an unbiased assessment of the facts. By agreeing to further the client's ends, Ernst & Young transformed a garden-variety contract into a fiduciary relationship.

Contractualists might say that in those cases, courts are still implying terms because the special circumstances where fiduciary duties arise are those where the parties would have negotiated enhanced duties if they had unlimited resources to bargain. Like in *Meinhard*, however, Ernst & Young and Cendant agreed to the terms of an engagement letter. And Cendant addresses in some detail why Cendant can simultaneously plead both contract and negligence-based claims. *Id.* at 604-06. If the contractualist view were correct, fiduciary claims would not survive in the face of a detailed contract. What is important is that courts impose extra-contractual duties, based on the character of the relationship, not the written contract.

286. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16(1) (2000) (stating that the lawyer must "advance a client's lawful objectives"); *see also* Cunningham v. Hamilton County, 527 U.S. 198, 206 (1999) ("Unlike witnesses, whose interests may differ substantially from the parties', attorneys assume an ethical obligation to serve their clients' interests."); Anders v. California, 386 U.S. 738, 744 (1967) ("The constitutional requirement of substantial equality and fair process can only be attained where counsel acts in the role of an active advocate in behalf of his client . . . .").

287. *See* GEOFFREY C. HAZARD JR. & ANGELO DONDI, LEGAL ETHICS: A COMPARATIVE STUDY 172 (2004).

288. Postema, *supra* note 141.

duty of zealous advocacy to the client.[289] The U.S. Supreme Court has noted the "identity of interests" between the lawyer and client.[290] The lawyer, unlike the accountant, must adopt the client's ends. It must work actively toward achieving the client's objectives, although no one can specify precisely what actions the attorney should take to achieve the client's ends.

A lawyer also has a duty to be independent, but the lawyer's independence differs from auditor independence. Geoffrey Hazard and Angelo Dondi explain that a lawyer's independence from the client entails refusing to assist the client with violating the law or to render advice that encourages a violation.[291] It is never in the client's interests to commit a violation of law. Independence from the client, in this respect, therefore, is consistent with promoting the client's ends, and Hazard and Dondi note that independence in the context of lawyers is consistent with the duty of loyalty, not opposed to it.[292]

An example of the lawyer's duty to adopt the client's end is the prohibition on contractual limitations of liability for malpractice. Under the *Model Rules*, a lawyer cannot negotiate with a client for a limitation on the lawyer's malpractice liability unless the client is independently represented.[293] The lawyer, therefore, cannot bargain at arm's length with her own client in an attempt to maximize their resources. The lawyer must make the principal's ends her own ends. In this case, that means ensuring the client is adequately represented by another lawyer, who will in turn adopt the client's ends, before the first lawyer can enter into a prospective limitation on liability.

Understanding the fiduciary obligation as a requirement to adopt an end also differentiates financial advisors and planners, as fiduciaries, from stockbrokers. A broker makes investment recommendations and executes securities transactions on the client's behalf. Making a

---

289. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. 1 (2006) ("A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf.").

290. *Cunningham*, 527 U.S. at 206.

291. HAZARD & DONDI, *supra* note 287, at 159.

292. *Id.* at 116.

293. MODEL RULES OF PROF'L CONDUCT R. 1.8(h) (2006).

single recommendation and executing a trade may entail judgment, but the judgment required is narrow in scope.[294] If a fiduciary duty exists, it typically ends when the order is filled.[295] The broker, therefore, is not concerned about the client's ends and a broker, absent special circumstances, is generally not considered a fiduciary.[296]

In some cases, a broker will owe a "special duty"—akin to a fiduciary duty—to provide ongoing advice to a customer as a result of special circumstances. Special circumstances include cases where the client is especially dependent on the broker, such as a customer with limited faculties or one who is so unsophisticated that the broker effectively controls the account.[297] In each of those cases, the broker would be required to engage his special sensitivities and be aware of the client's ends, and the broker would be considered a fiduciary.

Similarly, if a customer grants his broker "discretion" over an account, the rules change consistent with my approach. A grant of discretion means the broker may invest on the client's behalf and bind the client to the broker's decisions without the client's prior consent and courts hold that if a broker has investment discretion, the broker must fulfill fiduciary duties.[298] In that case, the

---

294. Under the federal securities laws, a broker can provide some advice to its customers and not be considered an advisor, subject to an advisor's fiduciary duties, as long as the advice is "solely incidental" to the brokerage services provided. Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C) (2000 & Supp. 4 2004).

295. *See* Caravan Mobile Home Sales v. Lehman Bros. Kuhn Loeb, 769 F.2d 561, 567 (9th Cir. 1985).

296. *See* cases cited *supra* note 43.

297. *See* De Kwiatkowski v. Bear Stearns & Co., 306 F.3d 1293, 1308 (2d Cir. 2002) ("The law thus imposes additional extra-contractual duties on brokers who can take unfair advantage of their customers' incapacity or simplicity."); *In re* E. F. Hutton & Co., Exchange Act Release No. 25,887, 41 SEC Docket 473 at 467-77 (July 6, 1988).

298. *See* United States v. Szur, 289 F.3d 200, 208 (2d Cir. 2002) ("Appellants correctly point out that a general fiduciary duty, triggering a duty to disclose, arises when brokers have discretionary authority over their customers' accounts."); Liang v. Dean Witter & Co., 540 F.2d 1107, 1112 n.23 (D.C. Cir. 1976) ("[T]he discretion of the broker is always subject to substantive review under his fiduciary duty of care . . . ."); Press v. Chem. Inv. Serv. Corp., 988 F. Supp. 375, 386 (S.D.N.Y. 1997) ("The crucial factor in determining whether a broker has been 'entrusted' with particular matters such that a fiduciary obligation attaches, appears to be whether the broker exercises discretion over

broker is acting more like an advisor. It has a duty to consider the subjective characteristics of the client and adopt the client's objectives as the broker's own.

Under the contractual model, all brokers should be fiduciaries because the problems of contract specification and monitoring are present. Brokers, however, generally are not fiduciaries; they have no duty to adopt the customers' goals, objectives, or ends. In those cases where the customer depends heavily on the broker or the relationship is discretionary, the broker must adopt the customers' ends and the law deems the broker in those instances to be a fiduciary.

Investment advisors are different. An advisor analyzes the client's situation and recommends securities transactions to the client on an ongoing basis to further the client's overall investment objectives. Advisors typically disclose to clients information needed to evaluate whether to establish a long-term relationship, such as information about the types of services provided, the nature and frequency of reports to clients, fees charged, methods of analysis or strategies used, affiliations with other securities professionals and attendant conflicts of interest, and a description of the advisor's education and business background.[299] This is the type of information the client needs before assessing whether the advisor can and will adopt the client's ends. It is no surprise that investment advisors are fiduciaries.

CONCLUSION

The view that fiduciary duties are a response to high costs of contract specification and monitoring is too broad in some respects and too narrow in others. Some relationships are marked by high costs of specification and monitoring,

---

those matters."). The SEC recently amended its rules drawing the line between brokers and advisors to clarify that a broker with discretion must consider the account an advisory account and, absent a relevant exception or exemption, register as an investment advisor, which is a fiduciary under the federal securities laws. Certain Broker-Dealers Deemed Not to be Investment Advisers, Exchange Act Release No. 51,523, Advisers Act Release No. 2,376, 70 Fed. Reg. 20,424 (Apr. 19, 2005), *vacated by* Fin. Planning Ass'n v. SEC, 482 F.3d 481 (D.C. Cir. 2007).

299. *See* Forms Prescribed under the Investment Advisers Act of 1940, 17 C.F.R. § 279.1 (2006) (Form ADV, the Uniform Application for Investment Adviser Registration, Part 2).

but they are not fiduciary relationships; others result in detailed contracts, yet courts impose fiduciary duties regardless of the contractual terms. Moreover, although some fiduciary rules can be renegotiated by the parties, many fiduciary duties are mandatory—and the mandatory duties are not the trivial type that can be easily ignored; they lie at the heart of the fiduciary's role. The contractual view of the fiduciary relationship, therefore, fails as an explanatory theory.

The fiduciary duty is better explained as a duty to adopt the objectives of the principal. The requirement to adopt the principal's ends is a unique type of obligation that sets fiduciaries apart from other service providers that act on behalf of another. The fiduciary duty is akin to an imperfect duty in Kant's system of duties. It is an open-ended duty that generally does not prescribe particular actions or omissions, but rather requires the fiduciary to embrace the principal's goals or objectives and act to help the principal to achieve them.

Understanding the fiduciary obligation as a duty to adopt the principal's ends helps explain leading fiduciary cases that employ the language of ends. In one area of fiduciary law after another—trusts, corporate law, insider trading—courts look to determine whether the fiduciary has adopted the ends of the principal. Viewing the fiduciary obligation as the adoption of ends also resolves why certain service providers, like lawyers and advisors, are fiduciaries while others, like auditors and stockbrokers, generally are not.