

# A LIBERAL THEORY OF FIDUCIARY LAW

[ WORKING DRAFT ]

Robert J. Rhee <sup>†</sup>

## Abstract

Fiduciary law requires a coherent theory. When courts are asked to determine whether a relationship is fiduciary, they do not have an operative rule absent statute or contract. They work through the facts with an inchoate idea. This state of incomplete knowledge would not be so problematic if the boundary of the principle is clear and the law is static. By hook or crook, case law and the law generally seem to have gotten the results about right. But there is uncertainty at the margins, and the boundary is continuously tested in litigation and academic conceptualization. Potential elasticity of the concept will test and stress the fiduciary principle as new fact patterns and social problems reveal themselves in the future. A theorization of the fiduciary law is important.

This article advances a liberal theory of the fiduciary relationship. The theory states that a fiduciary relationship arises when: (1) power exists in a relationship; (2) power exists in a systemic and structural state, (3) systemic, structural power negates an initial strong presumption of equal footing, and (4) systemic, structural power is exerted against a critical interest. An important contribution of this theory is that it is independent of correlative notions of “trust, confidence, and vulnerability.” These factors are too elastic and undistinguishing, more rhetoric than causality. The loci of the liberal theory are particular conceptions of power and interest and such power over such interest. Once the real causal elements are unpacked, the theory explains the law as it exists today, fitting into its framework all types of cases in which the law and courts have recognized a fiduciary relationship. As a normative theory, it affirms that the law is about right even if courts have worked from intuitions and inchoate analysis.

The liberal theory is called as such because it also solves a legitimacy problem. Fiduciary law imposes a mandatory code of stringent conduct on

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<sup>†</sup> John H. and Mary Lou Dasburg Professor of Law, University of Florida Levin School of Law. I thank Peter Molk for his helpful comments. I thank my research assistant Piers Rhee.

private relationships. A theory must harmonize the fiduciary principle with our political organization. The liberal theory, as a normative idea, is grounded in a foundation of our political economy. Fiduciary law should not conflict with the core values of a liberal, capitalist society with a strong market system. It should start from an initial strong presumption of liberty, agency, and private ordering, and permit intervention only when equal footing cannot be presumed because systemic, structural power is exerted against critical interests. The theory justifies a strong role of the law's intervention and paternalism under limited conditions and argues that this role advances important values of a liberal, capitalist society.

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## INTRODUCTION

The fiduciary relationship is an enigma. Despite centuries of legal recognition,<sup>1</sup> it has evaded conceptualization, or even a definitive operative rule that can be applied consistently and predictably when relationships are not based on status per statute or contract. Fiduciary relationships are prevalent, and in most cases the status is uncontested. In determining the law, no one questions whether trustees, partners, directors, officers, or lawyers are fiduciaries; the law is clear and the real controversy centers on the standard of conduct and breach. But courts also recognize ad hoc fact-based fiduciary relationships. Like the tradition of equity jurisprudence from whence the fiduciary principle came, these decisions are ad hoc and can be indeterminate.<sup>2</sup> The fiduciary principle is “one of the most elusive concepts in Anglo American law.”<sup>3</sup> We need to understand why the law endows a fiduciary status to some relationships but not to others.

The state of incomplete knowledge would not be so problematic as a pragmatic matter if the boundaries of the principle are clear and the law is static, *i.e.*, the rule works, never mind exactly how. While the status of most fiduciary relationships is uncontested in most cases, ad hoc fact-based recognition of fiduciary relationships, constituting a minority of all cases, is subject to uncertainty. Uncertainty in small numbers is an instrumental problem, an unpleasant surprise to the fiduciary, but not a larger problem *per se*. A better articulation of the theory should resolve some of the

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<sup>1</sup> The concept of a fiduciary relationship and duty can be traced to *Keech v. Sanford*, 25 Eng. Rep. 223 (1726), wherein the English chancellor ordered disgorgement of profit when, after a landlord refused to renew a lease held by a child beneficiary, the trustee acquired the lease for himself. He ordered this remedy “though I do not say there is a fraud in this case.” The case stands for the principle that the duty of loyalty is the utmost and a trustee must scrupulously avoid any conflict of interest in the administration of a trust.

<sup>2</sup> See Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 881 (1988) (“As a legal principle, the obligation originated in Equity. . . . The evolution of fiduciary obligation thus owed much to the situation-specificity and flexibility that were Equity’s hallmarks.”).

<sup>3</sup> *Id.* at 881. DeMott suggests that a unified theory is not possible: “One could justifiably conclude that the law of fiduciary obligation is in significant respects atomistic.” *Id.* at 915. See *infra* note 52. The search for a theory of fiduciary law has been likened to a search for the “holy grail.” Cecil J. Hunt, II, *The Price of Trust: An Examination of Fiduciary duty and the Lender-Borrower Relationship*, 29 WAKE FOREST L. REV. 719, 768 (1994); Leonard I. Rotman, *Fiduciary Law’s “Holy Grail”: Reconciling Theory and Practice in Fiduciary Jurisprudence*, 91 BOSTON U.L. REV. 921, 923 (2011).

problem. Any residual uncertainty would be the nature of law in action, no different from determining the line that divides negligence and the reasonable person. The larger problem is that the fiduciary principle is continuously tested in courts and theorized in academic commentary.<sup>4</sup> We live in a complex and dynamic society. Many of its problems can be seen through a fiduciary framework, thus testing and stressing the limits of rule and theory.<sup>5</sup> Fiduciary law deeply affects societal interests; it pervades corporations, partnerships, financial institutions, monies held in trust, and professions, and imposes a rigorous code of conduct over them. The uncertainty at the margins and elasticity of the concept in posterity calls for a proper theorization.

This article presents a liberal theory of fiduciary law: A fiduciary relationship arises when: (1) power exists in a relationship between obligor and obligee, (2) power exists in a systemic and structural state such that this *systructural* power creates articulable, easy to intuit classes or categories of relationships or types of dealings,<sup>6</sup> (3) systructural power relation negates an initial strong presumption of equal footing in human and commercial dealings in a market system, and (4) systructural power is exerted against

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<sup>4</sup> E.g., Matthew T. Bodie, *Employment as Fiduciary Relationship*, 105 GEO. L.J. 819 (2017) (arguing that employers owe fiduciary and quasi-fiduciary duties to employees); Ethan J. Leib, *Friends as Fiduciaries*, 86 WASH. U.L. REV. 665 (2009) (arguing that friends should be fiduciaries); Andrew W. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEX. L. REV. 1079 (2016) (arguing that investment bankers in M&A deals should be fiduciary advisers); Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should be Fiduciaries*, 87 WASH. U.L. REV. 707 (2012) (arguing that brokers should be fiduciaries); *supra* note 12 (citing works seeking to expand the fiduciary principle in the sphere of public law).

<sup>5</sup> There has been a spate of academic commentary in recent years. See generally FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur B. Laby & Jacob Hale Russell, eds., 2021); FIDUCIARIES AND TRUSTS: ETHICS, POLITICS, ECONOMICS AND LAW (Paul B. Miller & Matthew Harding, eds., 2020) [hereafter “FIDUCIARIES AND TRUSTS”]; Arthur B. Laby, *Advisors as Fiduciaries*, 72 FLA. L. REV. 953 (2020); THE OXFORD HANDBOOK OF FIDUCIARY LAW (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff, eds., 2019) [hereafter “OXFORD HANDBOOK”]; RESEARCH HANDBOOK ON FIDUCIARY LAW (D. Gordon Smith & Andrew S. Gold, eds., 2018) [hereafter “RESEARCH HANDBOOK”]; Evan J. Criddle, *A Republican Theory of Fiduciary Law*, 95 TEX. L. REV. 993 (2017); PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW (Andrew S. Gold & Paul B. Miller, 2014) [hereafter “PHILOSOPHICAL FOUNDATIONS”]; TAMAR FRANKEL, FIDUCIARY LAW (2011); Paul B. Miller, *A Theory of Fiduciary Liability*, 56 MCGILL L.J. 235 (2011).

<sup>6</sup> *Systructural* is not a typo. It is a neologism used here to connote the dual qualities of power that exists in a systemic and structural state. See *infra* note 105 and accompanying text (explaining the distinction between systemic and structural and the duality inherent in some forms of power).

critical interests, which are recognized interests in a liberal, capitalist society determined to be so important that the law intervenes in otherwise private affairs.<sup>7</sup> This liberal theory presents a normative theory of fiduciary law. In arguing that the normative concept aligns with existing law, the liberal theory is also a positive theory. Applied, the theory explains all classes and categories of fiduciary relationships seen in the law today. Thus, I conclude that, generally and in the main, fiduciary law as it exists today is about right.

The loci of the liberal theory are particular conceptions of power and interest and such power over such interest. A major contribution of the liberal theory is that it is independent of correlative notions of “trust, confidence, and vulnerability,” which conventional accounts cite as important elements of a fiduciary relationship. These attributes are not elemental, but instead are observational rationalizations. The rhetoric of “trust, confidence, and vulnerability” clouds more than it illuminates; it is unhelpful even instrumentally for they are not dispositive. We see these attributes in most fiduciary relationships, and many other non-fiduciary relationships as well, and that is the problem. Anecdotes of life abound with relationships built on trust, confidence, and vulnerability. Yet very few are fiduciary relationships. Strictly, trust, confidence, and vulnerability are unnecessary to establish a fiduciary relationship.<sup>8</sup> Cases and academic commentary emphasizing their centrality have been drawn to the light of the apparent rather than an inquiry into the hidden cause of the light.

Another major contribution of the liberal theory is that it solves a legitimacy problem. It is called as such because it has a political economic foundation. The concept of a fiduciary should be situated in the political and economic organization of a liberal, capitalist society that relies much on the market system and places high value on autonomy, human agency, and law’s inclination to leave be private affairs. The imposition of a fiduciary relationship is a paternalistic act; it imposes a certain moral standard of

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<sup>7</sup> See *infra* Section II (presenting the theory and explaining the elements).

<sup>8</sup> See *infra* Section II.C. At the start of this project, I held the conventional notion that trust, confidence, and vulnerability were important elements of a fiduciary relationship, but my viewpoint has changed. The evolution of this project has revealed that these factors are correlative but not causal. The correlative aspect may assist courts in an instrumental function, but is not necessary to a theorization of a fiduciary relationship.

conduct and duties into otherwise private affairs.<sup>9</sup> The law does and should intervene only when these presumptions are negated by systructural power over critical interests. Conflict with the first principle of a liberal society — liberty and autonomy — is justified because aspects of interactions, including the market system itself, can be systructurally deficient, and because critical interests are at stake, such as money and wealth, wellbeing of body and mind, and other rights-based interests. When its exact elements are present, fiduciary law enables fiduciary relationships such that, on balance, interference in private affairs is justified and the fiduciary relationship is consistent with society's political and economic organization. This reality has much explanatory and normative power.

The liberal theory works at the concrete instrumental level of stating a tangible rule of law. Derived from the theory, the instrumental rule places tangible limits on rule elasticity. The concept of the fiduciary relationship is subject to the push and pull of competing visions. Contractarians and libertarian-oriented commentators seek to diminish or even eliminate the fiduciary concept in favor of a contract analysis;<sup>10</sup> others seek to expand the concept to various new situations and categories of relationships.<sup>11</sup> A part of this article's project is to explain the existing legal framework based on this prior: When a principle has been worked out by legislatures and courts over the course of hundreds of years and no one can honestly call the overall result a social failure, the law has generally worked. What are the underlying dynamics of this working? This article explains the law through a more coherent, analytical conceptualization.

The liberal theory provides a workable framework to facilitate analysis of future cases seeking to test the boundaries of the fiduciary principle as we confront new social problems. Flexibility of law is salutary. In this spirit, the liberal theory is sufficiently constrained so that the paternalism of law, the unavoidable facet of a fiduciary relationship, is not unbounded, but like the common law, the theory is sufficiently pliable nevertheless for future development and use.

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<sup>9</sup> See *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C.J.) ("A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."). See also *infra* Section III.A. (discussing autonomy and paternalism in the context of liberalism).

<sup>10</sup> See *infra* note 57 and accompanying text.

<sup>11</sup> See *supra* note 4.

Section I explains the fiduciary relationship in law. In most cases, the law is clear, but inconsistencies exist at the margins of the doctrine. The law has been undertheorized by courts. This section provides a literature review of academic commentary.

Section II presents the liberal theory of fiduciary law. It states the core elements: power existing in a systemic and structural state, negation of equal footing, and systructural power over a critical interest. Each element is explained and analyzed.

Section III discusses the foundation of the liberal theory. Fiduciary law must be situated within the political economy. Because the law interferes with otherwise private affairs in a paternalistic way, it must be reconciled with the values of a liberal society.

Section IV explains the instrumental attributes of the liberal theory. The theory explains existing law and concludes its general correctness. It sufficiently constrains the fiduciary principle, but is pliable and elastic enough for posterity.<sup>12</sup>

## I. BACKGROUND

### A. Fiduciary Relationships in the Law

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<sup>12</sup> Before undertaking the analysis, a limitation on the scope of the inquiry is stated. This article is limited to the realm of private law. Fiduciary principles may have application in the sphere of public law or a hybrid public-private interface in law. See FIDUCIARY GOVERNMENT (Evan J. Criddle et al., eds., 2018); Ethan J. Leib & Stephen R. Galoob, *Fiduciary Political Theory: A Critique*, 125 YALE L.J. 1820 (2016); Edward B. Foley, *Voters as Fiduciaries*, 2015 U. CHICAGO LEGAL FORUM 153; D. Theodore Rave, *Politicians as Fiduciaries*, 126 HARV. L. REV. 671 (2013); David L. Ponet & Ethan J. Leib, *Fiduciary Law's Lessons for Deliberative Democracy*, 91 BOSTON U.L. REV. 1249 (2011); Rob Atkinson, *For-Profit Managers as Public Fiduciaries*, in FIDUCIARIES AND TRUSTS, at 275-301; Paul B. Miller, *The Fiduciary Relationship*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 86-89; RESEARCH HANDBOOK, *supra* note 5, at 379-436 (various chapter contributions); Evan Fox-Decent, *New Frontiers in Public Fiduciary Law*, in OXFORD HANDBOOK, *supra* note 5, at 909-24. Such application is intriguing. One intuits that it may require a modified set of considerations and perhaps a different theory altogether. For this author, intellectual gluttony may be a vice, and so the thought is reserved for another day, perhaps. The challenge of theorizing a general rule of fiduciary law in private law is difficult enough.

Fiduciary relationships can be created by statute, contract, or case law.<sup>13</sup> A fiduciary relationship begets stringent duties on the fiduciary to the beneficiary, the duties of care and loyalty.<sup>14</sup> When there is a breach of stringent behavior, fiduciary law brings to bear a full range of remedies including equitable remedies such as disgorgement and constructive trust.<sup>15</sup> For most practitioners and in most fields of practice, there is actually much certainty. Well established law or contract control. Certain categories of persons and relationships are clearly fiduciaries based on their status and relationship with beneficiaries, and we do not question the status, *e.g.*, trustees, partners, directors, officers, guardians, and lawyers.<sup>16</sup> Some relationships are often found to be fiduciary based on the situational context, *e.g.*, doctors, advisers, and confidential relationships.<sup>17</sup> Equally clear,

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<sup>13</sup> *E.g.*, UNIFORM TRUST CODE § 802(a) (trustee); REVISED UNIFORM P'SHP ACT § 404(a) (Unif. Law Comm'n 1997 and harmonized 2013) (partners); *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009) (officers and directors); *Matter of Piatt*, 951 P.2d 889 (Ariz. 1997) (en banc) (lawyers). *See In re McCarthy*, 350 B.R. 820, 834 (Bankr. N.D. Ind. 2006) (noting that "a contract, statute, or ordinance may create a fiduciary relationship"); Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 795-808 (1983) (describing various kinds of fiduciary relationships and their sources in contract and law); Miller, *supra* note 5, at 240-47, 252 (discussing status-based or fact-based fiduciary relationships); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1412-13, 1451-66 (2002) (describing the various kinds of fiduciary relationships).

<sup>14</sup> *E.g.*, *supra* note 9; RESTATEMENT (THIRD) OF AGENCY §§ 8.01-8.12 (2005) (setting forth the duties of an agent to the principal).

<sup>15</sup> *See* Samuel L. Bray, *Fiduciary Remedies*, in OXFORD HANDBOOK, at 449-67.

<sup>16</sup> *See* Smith, *supra* note 13, at 1413 ("Many of these relationships have been considered fiduciary in nature for centuries, and any attempt to explain that status seems unnecessary."); DeMott, *supra* note 2, at 908 (listing paradigm relationships that are unquestionably fiduciary in nature); Miller, *supra* note 12, at 64 ("[W]e say with confidence that lawyers, directors, agents, and trustees are fiduciaries, and perhaps with some diffidence that parents, doctors, and public officials are (or should be) so considered."); Laby, *supra* note 5, at 997 ("Status-based fiduciaries include trustees, partners, corporate directors, lawyers, and others."). Occasionally, commentators, often grounded in particular methods or viewpoints, seek to overturn long established doctrine or understanding. For example, Frank Easterbrook and Daniel Fischel argue that fiduciary law is not distinct and is simply a subset of contracts, and Larry Ribstein questions the traditional fiduciary status of partners. *See infra* Section I.C., notes 57-78 and accompanying text (discussing Easterbrook and Fischel's idea); *infra* note 184 (discussing Ribstein's idea). For different reasons, these arguments are unpersuasive. *See infra* Sections I.C. and IV.B.

<sup>17</sup> *E.g.*, *Meardon v. Register*, 994 F.3d 927, 937 (8th Cir. 2021) (noting that "fiduciary, or confidential relationships, can 'exist[] when one person has gained the confidence of



customers, franchisees, counterparties, debtors, and friends are not fiduciary beneficiaries based on their status alone.<sup>18</sup> Most fiduciary relationships are based on clearly delineated relationships that the law has recognized over the course of many years, and in most cases, one ventures to guess, the fiduciary status is not a contested issue.

Yet the idea of a fiduciary relationship is elusive. A key attribute in most fiduciary relationships is discretionary authority over the beneficiary or her interest.<sup>19</sup> The quintessential fiduciary is the trustee: a beneficiary

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another and purports to act or advise with the other's interest in mind"); *Advocare Int'l LP v. Horizon Labs., Inc.*, 524 F.3d 679, 695-96 (5th Cir. 2008) (noting that "a fiduciary duty may arise informally from a 'relationship of trust and confidence'"); *Carr v. CIGNA Securities, Inc.*, 95 F.3d 544, 547 (1996) (noting that "a broker is not a fiduciary of his customer unless the customer entrusts him with discretion to select the customer's investments"); *Keogan v. Holy Family Hosp.*, 622 P.2d 1246, 1252 (Wash. 1980) (en banc) (noting that a doctor has a fiduciary duty to a patient with respect to informed consent). See Even J. Criddle, *Stakeholder Fiduciaries*, in *FIDUCIARIES AND TRUSTS*, *supra* note 5, at 105 ("A fiduciary's beneficiary status may be a fixed structural feature of a particular type of fiduciary relationship (e.g., partnership), or it may be dependent on contingent features of specific relationships (e.g., spouses who acquire community property).").

<sup>18</sup> E.g., *Ahrendt v. Granite Bank*, 740 A.2d 1058, 1061 (N.H. 1999) ("the relationship between a bank and a customer is not a fiduciary one unless the law otherwise specifies"); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 347 (4th Cir. 1998) ("there is no indication that a North Carolina law would recognize the existence of a fiduciary relationship between franchisee and franchisor"); *Negrete v. Citibank, N.A.*, 187 F.Supp.3d 454, 464 (S.D.N.Y. 2016) ("Citi is not required to advise trading counterparties, to whom it owes no fiduciary duty"); *United States v. Litvak*, 889 F.3d 56, 61 (2d Cir. 2018) (ruling that in context of arm's-length transactions, broker-dealer "acts solely in its own interest as a principal," is not an agent for its counterparties and owes "no special or fiduciary duty"); *Black Canyon Racquetball Club, Inc. v. Idaho First Nat'l Bank*, 804 P.2d 900, 905 (Idaho 1991) ("the relationship in a lender-borrower situation is a debtor-creditor relationship and not a fiduciary relationship"); *Smith v. Walden*, 549 S.E.2d 750, 757 (Ga.App. 2001) ("But mere friendship and close fellowship, without more, do not create a fiduciary relationship."); *Crestwood Farm Bloodstock v. Everest Stables, Inc.*, 751 F.3d 434, 443 (6th Cir. 2014) ("Many friends do business together. But not all friends are fiduciaries, and in the world of arms-length commercial negotiations few are."). See Hunt, *supra* note 3, at 736 ("The courts are virtually unanimous in holding that the basic relationship between lenders and borrowers is an arm's-length transaction between creditors and debtors.").

<sup>19</sup> E.g., *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 which are controlled by no other specific duty imposed by the trust instrument or the legal regime."). See Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975) ("First, the fiduciary must have scope for the exercise of discretion, and, second, this discretion must be capable of

places trust and confidence in a trustee, who has been endowed with discretionary authority over the beneficiary's interest, resulting in the beneficiary being placed in a position of vulnerability if such power is abused. However, mere authority for safekeeping of some important interest to another does not create a fiduciary duty. A friend can entrust a highly prized antique car for safekeeping including some discretionary authority for its use and care, but that would not create a fiduciary duty, though there is trust, confidence, vulnerability, and an important interest at stake.<sup>20</sup> Moreover, discretionary authority is not the sine qua non of a fiduciary relationship. It is well established that courts have routinely found advisers who lack such authority to be fiduciaries.<sup>21</sup>

The concept of a fiduciary relationship was first conceived by the English courts in equity.<sup>22</sup> Statutes sometimes curtly explain why they bestow fiduciary status,<sup>23</sup> but do not generally expound on principles. For explication, we look to courts. Absent a clear statutory or contractual status, fact finding and legal analysis require courts to explain the nature of the

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affecting the legal position of the principal."); Frankel, *supra* note 13, at 809 n.47 ("The term 'power' here means an ability to make changes that affect the entrustor.").

<sup>20</sup> E.g., French v. Hickman Moving & Storage, 400 N.E.2d 1384, 1389 (Ind.App. 1980) (holding bailor-bailee relationship is not a fiduciary relationship).

<sup>21</sup> E.g., Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992) (Posner, J.). See Criddle, *supra* note 5, at 1035-36 ("courts have also held that advisers may qualify as fiduciaries even if they lack formal authority to exercise their advisees' legal rights"); Laby, *supra* note 5, at 963 ("many advisors are considered fiduciaries although they lack discretionary authority over their advisory clients."); RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. c (2005) ("Agents who lack authority to bind their principals to contracts nevertheless often have authority to negotiate or to transmit or receive information their behalf. . . . The adviser may be subject to a fiduciary duty of loyalty even when the adviser is not acting as an agent.").

<sup>22</sup> See *supra* note 1; Henry E. Smith, *Why Fiduciary Law Is Equitable*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 261 (explaining the essential characteristic of a fiduciary relationship as based on equity jurisprudence).

<sup>23</sup> E.g., ARIZ. REV. STAT. § 46-456(A) ("A person who is in a position of trust and confidence to an incapacitated or vulnerable adult shall act for the benefit of that person to the same extent as a trustee . . ."); FLA. STAT. § 415.102(11) ("fiduciary relationship" is "a relationship based upon the trust and confidence of the vulnerable adult in the caregiver, relative, household member, or other person entrusted with the use or management of the property or assets of the vulnerable adult").

fiduciary relationship.<sup>24</sup> They sometimes recognize fiduciary duty on an ad hoc fact basis.<sup>25</sup> In these cases, they have consistently identified traits such as “trust” and “confidence” and “vulnerability” as core elements of a fiduciary relationship.<sup>26</sup>

A good example of how courts analyze the issue is *Burdett v. Miller*.<sup>27</sup> There, Burdett was an unsophisticated person in matters of investments, and Miller persuaded her to invest in investment schemes that ultimately failed.<sup>28</sup> Miller had a personal interest in the investment scheme, but did not disclose this conflict of interest or any other important information about the investment.<sup>29</sup> He was also Burdett’s friend for several years, her personal accountant and former teacher, and a professor of accounting.<sup>30</sup> He did not have discretionary authority over Burdett’s money and was not endowed with a fiduciary status through some formal relationship; he was instead only a friend and an adviser. The court per Judge Posner upheld the trial court’s factual finding of a fiduciary relationship under common law.<sup>31</sup> It noted the importance of trust, confidence, vulnerability, expertise and

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<sup>24</sup> See Miller, *supra* note 5, at 249 (“The fact-based approach is an important advance on the status-based approach inasmuch as it directs attention to general characteristics of fiduciary relationships.”).

<sup>25</sup> See Andrew S. Gold, *Trust and Advice*, in FIDUCIARIES AND TRUST, *supra* note 5, at 44 (“Fiduciary relationships extend more widely than categorical cases such as trustee-beneficiary, guardian-war, principal-agent or lawyer-client. They also include fact-based, or ad hoc, fiduciary relationships.”); Miller, *supra* note 12, at 67 (In the rare case that a plaintiff is unable to prove a relationship of settled fiduciary status, she may argue either for a *de novo* extension of status or a one-off judgment that the relationship is fiduciary.”).

<sup>26</sup> E.g., *Brown v. Wells Fargo Bank, NA*, 168 Cal.App.4th 938, 961-62 (2008) (“when the facts establish that an investment professional has previously voluntarily induced a vulnerable individual to repose trust and confidence in the professional, that professional has a fiduciary duty toward that individual”) (emphasis omitted); *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992) (Posner, J.) (“A fiduciary relation arises only if ‘one person has reposed trust and confidence in another who thereby gains influence and superiority over the other.’”).

<sup>27</sup> Commentators frequently cite this case as an example of an ad hoc fact-based fiduciary. E.g., Gold, *supra* note 25, at 45-46; Laby, *supra* note 5, at 1014-15.

<sup>28</sup> *Burdett v. Miller*, 957 F.2d 1375, 1378-79 (7th Cir. 1992) (Posner, J.).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 1381-82.

knowledge, stating that at its core “the fiduciary principle is designed to prevent trust from being misplaced.”<sup>32</sup>

The court did not state a rule of law so much as recite the litany of factors to consider. It focused on three key factors. The first is the link between trust and power: “The common law imposes that duty when the disparity between the parties in knowledge or power relevant to the performance of an undertaking is so vast that it is a reasonable inference that had the parties in advance negotiated expressly over the issue they would have agreed that the agent owed the principal the high duty that we have described, because otherwise the principal would be placing himself at the agent’s mercy.”<sup>33</sup> The second factor is the link between trust and vulnerability: “A fiduciary relation arises only if ‘one person has reposed trust and confidence in another who thereby gains influence and superiority over the other.’”<sup>34</sup> The third factor is the link between trust and expertise: “If a person solicits another to trust him in matters in which he represents himself to be expert as well as trustworthy and the other is not expert and accepts the offer and reposes complete trust in him, a fiduciary relation is established.”<sup>35</sup>

## B. Observable Facts and Under-Theorization

Superficially, *Burdett*’s analysis goes down as easy as twenty-year old scotch. Good facts help. The case clearly showed trust, confidence, vulnerability, power, and expertise. Applying these factors to other settings, we would easily agree that trustees, lawyers, directors, officers, guardians, and partners should be fiduciaries.<sup>36</sup> The court’s decision upholding an hoc finding of a fiduciary relationship seems right.<sup>37</sup> But upon some

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<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* (quoting *Amendola v. Bayer*, 907 F.2d 760, 763 (7th Cir. 1990)).

<sup>35</sup> *Id.*

<sup>36</sup> Occasionally, commentators have a contrarian view. *See infra* note 184 (discussing commentary suggesting that partners should not have default fiduciary duties).

<sup>37</sup> “Miller cultivated a relation of trust with Burdett over a period of years, holding himself out as an expert in a field (investments) in which she was inexperienced and unsophisticated. He knew that she took his advice uncritically and unquestioningly and that she sought no ‘second opinion’ or even—until the end, when at last her suspicions

consideration, an unrefined aftertaste lingers. If taken literally, the invocation of “trust, confidence, and vulnerability” is too overbroad and undistinguishing for an instrumental rule, no less a coherent theory.

Consider trust, a universally recognized factor.<sup>38</sup> It cannot be a dispositive element. Case law is replete with examples of fiduciaries who do not trust each other.<sup>39</sup> There is no rule that says dysfunctional partners are not fiduciaries. In the human condition, trustful relationships can result in betrayal or disappointment. The same can be said for confidence in a person and one’s vulnerability based on trust. A moment’s thought reveals the obvious. Trust, confidence, and vulnerability do not per se create a fiduciary relationship.<sup>40</sup> It cannot be that these ubiquities in the human condition categorically subject relationships to the fiduciary imprimatur.

Like trust, power is universally cited as a necessary element. This article uses the general definition of power: any trait of coercive influence on a person or her interest.<sup>41</sup> Formal authority and legal status are the clearest, strongest form of power. When formal discretionary authority is bestowed, there is little controversy in law or theory. But power exists in

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were aroused – any documentary confirmation of the investments to which he steered her.” *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992).

<sup>38</sup> See Carolyn McLeod & Emma Ryman, *Trust, Autonomy and the Fiduciary Relationship*, in *FIDUCIARIES AND TRUST*, *supra* note 5, at 74 (“According to most accounts of (bilateral) fiduciary relationships, trust is an important element of a well-functioning fiduciary relationship.”).

<sup>39</sup> E.g., *In re Murrin Brothers 1885, Ltd.*, 603 S.W.3d 53 (Tex. 2019) (owners suing each other after acrimonious relationship); *Red River Wings, Inc. v. Hoot, Inc.*, 751 N.W.2d 206 (N.D. 2008) (same).

<sup>40</sup> See *Daktronics, Inc. v. McAfee*, 599 N.W.2d 358, 363 (S.D. 1999) (“One party cannot transform a business relationship into one which is fiduciary in nature merely by placing trust and confidence in the other party.”). See also Criddle, *supra* note 16, at 108 (“Although entrusted power is a necessary criterion for the creation of a fiduciary relationship recognized under law, interpersonal trust is not. . . . In short, the law does not care whether beneficiaries subjectively trust their fiduciaries.”); Gold, *supra* note 25, at 35 (“Trust is not an inevitable component of fiduciary relationships. . . . Clients don’t have to trust their lawyers, and shareholders don’t have to trust their corporation’s directors.”); James Edelman, *The Role of Status in the Law of Obligations: Common Calling, Implied Terms, and Lessons for Fiduciaries Duties*, in *PHILOSOPHICAL FOUNDATIONS*, *supra* note 5, at 25 (“The label ‘fiduciary’ is also misleading due to its etymology in ‘trust’ and ‘confidence.’ It is well known that ‘fiduciary duties’ can arise despite the absence of any relationship of trust or confidence.”); Smith, *supra* note 13, at 1413 (“Trust alone is not enough, though courts often speak loosely in ways that suggest otherwise – nor is vulnerability.”).

<sup>41</sup> See *infra* note 108 (providing dictionary definition of “power”).

different forms. One form is hierarchy. Like trust, hierarchy is another universal feature of society: *e.g.*, employer-employee, supervisor-subordinate, adviser-advisee, coach-player, priest-parishioner, parent-child, common carrier-customer, customer-business, business-supplier, teacher-student, and potentially other relationship. Unless constrained, the concept of power as an observation of any unique structure of a relationship is an unworkable concept.

Aside from discretionary authority, perhaps an attribute that arguably qualifies power to form a fiduciary relationship should be knowledge and expertise, either knowledge of a specialized field or information asymmetry. These attributes are typically found in professional advisers such as lawyers, accountants, and investment advisers.<sup>42</sup> These attributes consistently create a power disparity and thus vulnerability. But this reasoning cannot hold either. Knowledge and expertise do not exist as erudite silos in society. All sorts of disparities exist in human relations: *e.g.*, doctors, professors, financiers, mechanics, caretakers, teachers, smart people, diligent people, people with graduate degrees, etc. The power inequity due to disparity in knowledge or expertise or information asymmetry cannot create a fiduciary relationship *per se*. The *Burdett* court emphasized knowledge and expertise, but quickly caveated the proposition in the same sentence: “We have emphasized knowledge and expertise, but we do not mean to suggest that every expert is automatically a fiduciary.”<sup>43</sup> Again, it cannot be that ubiquities in the human condition—power, knowledge, expertise, information asymmetry—are categorical marks of fiduciary imprimatur.

Commentators have intuited the problem with hypotheticals drawn from daily life. Is an auto mechanic, who is trusted, has expert knowledge, and places the customer in a vulnerable position with respect to a rare antique car, a fiduciary?<sup>44</sup> A friend who betrays another in a business

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<sup>42</sup> See Laby, *supra* note 5, at 963-74 (discussing the fiduciary status of various advisers including lawyers, business advisers, doctors, and investment advisers).

<sup>43</sup> *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992).

<sup>44</sup> See Frankel, *supra* note 13, at 808 (“Not all service relations are automatically fiduciary, however. Some may be classified as contractual, such as electricians’ and repairmen’s services.”); Criddle, *supra* note 5, at 1042 (noting that courts have concluded that auto mechanics and home contractors are not fiduciaries); Joshua Getzler, *Ascribing and Limiting Fiduciary Obligations: Understanding the Operation of Consent*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 43 (noting the example of an auto mechanic).

deal?<sup>45</sup> A career counselor who gives awful advice to work for Enron rather than Apple? <sup>46</sup> An investment banker husband who gives terrible investment advice to his wife? An employee who denounces her firm's human rights policy to the media? Is Rasputin a fiduciary of the Romanovs? Consider this hypothetical: a famous "psychic to the stars" has an "exclusive consultatory practice" in Beverly Hills, and she influences a vulnerable, trusting actor with tragic consequences on his wealth and wellbeing. Recognizing a fiduciary relationship in these situations results in the government's imposition of fiduciary duties with moral undertones and legal and equitable remedies for breach in private relationships.<sup>47</sup> We intuit that these situations should not create a fiduciary relationship even though they are in the context of high trust, high vulnerability, and high stakes, and some involve expertise, special knowledge, or information asymmetry. An analytical framework must support the intuition that most relationships exhibiting the litany of factors said to be essential should not beget a fiduciary relationship nonetheless.

The fiduciary principle is the stranger who is familiar to us. The law seems about right if the case outcome in *Burdett* and similar ad hoc cases serve as a litmus test. But the visual framework of the law lacks analytical rigor. There is uncertainty at the margins.<sup>48</sup> Most commentators have rightly concluded that a finding of trust, confidence, vulnerability, power, expertise, knowledge, or information asymmetry is not enough.<sup>49</sup> Such

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<sup>45</sup> See Leib, *supra* note 4, 700-07 (showing that some courts have been skeptical of friends as such as fiduciaries).

<sup>46</sup> See Laby, *supra* note 5, at 960 (giving examples of a career counselor and a librarian).

<sup>47</sup> See *supra* note 9.

<sup>48</sup> Ad hoc fact-based fiduciary status may be subject to uncertainty. A fiduciary can be like partners who unwittingly form a partnership. *E.g.*, *Byker v. Mannes*, 641 N.W.2d 210, 216 (Mich. 2002) ("individuals would be found to have formed a partnership if they acted as partners, regardless of their subjective intent to form a partnership"); REVISED UNIF. P'SHIP ACT § 202(a) (Unif. Law Comm'n 1997 and harmonized 2013) (partnership can be formed "whether or not the persons intend to form a partnership"). A person may have unknowingly become a fiduciary, thus assumed without specific intent potential liability. See Gold, *supra* note 25, at 47 (noting that like partners who did not realize they formed a partnership requiring fiduciary obligations, ad hoc fiduciaries "may have no idea that he is a party to a set of legal obligations that govern him as a fiduciary").

<sup>49</sup> See Smith, *supra* note 13, at 1413 ("While courts use various formulations to describe informal fiduciary relationships, the common elements are quite simple: (1) 'trust'

observable traits can be attributable to all sorts of relationships in the market and the personal realms. The traits could be seen as a part of a holistic assessment. But that thought is also unhelpful. How does a holistic assessment actually work? Do chancellors in equity have different measures of a foot?<sup>50</sup> The concern is an unmoored concept and indeterminacy.<sup>51</sup> If commonly listed traits are accepted literally, they would be too overbroad, susceptible to unchecked expansion and agendas.<sup>52</sup> Like the various

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or 'confidence' reposed by one person in another; and (2) the resulting 'domination,' 'superiority,' or 'undue influence' of the other. Trust alone is not enough, though courts often speak loosely in ways that suggest otherwise—nor is vulnerability. Only in the aggregate do these factors give rise to a fiduciary relationship.”); Rotman, *supra* note 3, at 931 (“The simple inequality of parties is not, therefore, determinative of the existence of a fiduciary relationship.”); Paul D. Finn, *The Fiduciary Principle*, in EQUITY, FIDUCIARIES AND TRUSTS 1, 46 (Timothy G. Youdan ed., 1989) (noting “it is obvious not enough” that factors such as trust, confidence, vulnerability, power, and information asymmetry exist); Peter Birks, *Equity in the Modern Law: An Exercise in Taxonomy*, 26 W. AUSTRALIA L. REV. 1, 17 (1996) (“The difficulty with 'fiduciary' is that its meaning has been allowed to become completely uncertain.”); Sarah Worthington, *Fiduciaries: When is Self-Denial Obligatory*, 58 CAMBRIDGE L.J. 500, 505 (1999) (“But the difficulty has always been that these descriptors, although apt to describe relationships where fiduciary obligations are imposed, are often equally apt when such obligations are absent. It follows that they cannot adequately and restrictively define the incidence of fiduciary obligations.”); Miller, *supra* note 5, at 256 (“While inequity, dependence, and vulnerability are now routinely identified as qualities of fiduciary relationships that justify fiduciary duties, their meaning and salience have not been consistently stated or properly explained.”); Criddle, *supra* note 5, at 1032, 1036 (“[T]he fact that one person subjectively trusted another—is neither necessary for nor conclusive of the existence of a fiduciary relationship. . . . The trouble with basing fiduciary duties on such vague concepts as power, vulnerability, and the threat of opportunism, however, is that these factors are present in *all* private relationships.”) (quotation marks omitted).

<sup>50</sup> “Equity is a roguish thing. . . . ‘Tis all one as if they should make the standard for the measure we call a ‘foot’ a Chancellor’s foot; what an uncertain measure would this be! One Chancellor has a long foot, another a short foot, a third an indifferent foot. ‘Tis the same thing in the Chancellor’s conscience.” Nixon v. Blackwell, 626 A.2d 1366, 1378 n.17 (Del. 1993) (quoting John Selden, in *Equity*, Table-Talk (1689)).

<sup>51</sup> See Smith, *supra* note 22, at 278 (“As with equity, scholars have criticized fiduciary duty for being unpredictable around the edges.”).

<sup>52</sup> See Wilson v. IBP, Inc., 558 N.W.2d 132, 139 (Iowa 1996) (“Although domination and control are significant factors, neither are determinative by themselves. Rather, we are cognizant of the fact that ‘[b]ecause the circumstances giving rise to a fiduciary duty are so diverse, any such relationship must be evaluated on the facts and circumstances of each individual case.’”). See also Miller, *supra* note 5, at 249-50 (“Efforts to identify and list characteristics of a thing, actual or conceptual, may be of little use in revealing its essential nature. . . . Like the status-based approach, then, the fact-based approach is unprincipled.”).



metaphors used in the corporate veil piercing doctrine, another principle arising from equity jurisprudence, they are unhelpful.<sup>53</sup> Ultimately, courts have taken a “I know it when I see it” approach to finding a fiduciary relationship.<sup>54</sup>

A coherent theory of fiduciary law is needed. Notions of trust, confidence, vulnerability, and power disparity are correlative observations, but are not causal elements. They are the byproducts of relationships found to be fiduciary in nature. They are the inevitable light of a star we see, but are not the hidden nuclear forces that birthed the light deep inside the core. We do not have a generally accepted theory of a fiduciary relationship, a theory of the elements of the relationship and their dynamics.

### C. Literature Review and Current Theories

The fiduciary relationship is undertheorized in the law. In response, the academic literature is burgeoning. Some commentators have suggested that a whole theory does not exist.<sup>55</sup> Others have been more sanguine and have proposed various ideas.<sup>56</sup> I survey the ideas of some of the most prominent commentators.

A starting point is an extreme idea that should be mentioned, but then rejected as wrong. Some economists and legal scholars with an economic bent argue that fiduciary duty is not a separate idea, but is simply a form of contract. Frank Easterbrook and Daniel Fischel prominently argue that “[c]ontract and fiduciary duty lie on a continuum best understood as using

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<sup>53</sup> See Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 83-84 n.7 (2010) (“The inherent imprecision in metaphors has resulted in a doctrinal mess.”).

<sup>54</sup> See *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (“I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.”).

<sup>55</sup> See Miller, *supra* note 12, at 65 (“The dominant academic view is that the fiduciary relationship is indefinable.”); DeMott, *supra* note 2, at 909 (“[O]nly an instrumental view of fiduciary obligation can address such a diversity of contexts.”).

<sup>56</sup> E.g., J. C. SHEPHERD, *THE LAW OF FIDUCIARIES* 51-88 (1981) (listing seven different theories of the fiduciary relationship).

a single, although singularly complex, algorithm.”<sup>57</sup> The basic idea is that actual contracting is preferable when transaction costs permit, but when they are prohibitively high courts fill gaps in the contract through “fiduciary” law, which is simply a gap filling contract principle.<sup>58</sup> The purpose of their project is to move all fiduciary duties to actual contracting, subject only to the feasibility of transaction costs,<sup>59</sup> which presumably the parties would be in the best position to assess the costs of contracting, necessitating required recognition of all contracts for fiduciary duties when they are made. Thus, Easterbrook and Fischel dismisses fiduciary law as a figment of the legal imagination: “Searching for the right definition of a fiduciary duty is not a special puzzle. In short, there is no subject here, and efforts to unify it on a ground that presumes its distinctiveness are doomed.”<sup>60</sup>

The idea has not aged well. Robert Stikoff notes that the major problem with the idea. Pure contractualism does not explain mandatory rules very well.<sup>61</sup> A discussion of developments in the laws of business organizations, including Delaware’s, reveals this problem. These laws distinguish mandatory fiduciary duties from contracts, either real or more abstract. Some business forms, principally the limited liability company,

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<sup>57</sup> Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 446 (1993). See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 92-93 (1991) (“Because the fiduciary principle is a rule for completing incomplete bargains in a contractual structure, it makes little sense to say that ‘fiduciary duties’ trump *actual* contracts.”).

<sup>58</sup> “So, we conclude, a ‘fiduciary’ relation is a contractual one characterized by unusually high costs of specifications and monitoring. . . . That objective calls for filling gaps in fiduciary relations the same way courts fill gaps in other contracts.” Easterbrook & Fischel, *supra* note 57, at 426-27, 429 (citing R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960)). “When transactions costs reach a particularly high level, some persons start calling some contractual relations ‘fiduciary,’ but this should not mask the continuum.” *Id.* at 438.

<sup>59</sup> “When actual contracts are reached, courts enforce them; when actual contracts are feasible, courts induce parties to bargain; when transactions costs are too high, courts establish the presumptive rules that maximize the parties’ joint welfare.” *Id.* at 446. The implication here is that when parties actually agree to bargain, they should be allowed to contract as they presumably know best whether transaction costs are prohibitive or not.

<sup>60</sup> *Id.* at 438.

<sup>61</sup> See Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 198, 205 (“Committed economic contractarians, such as Easterbrook and Fischel, have had difficulty in explaining why the parties to a fiduciary relationship do not have complete freedom of contract.”).

permit high degree of actual contracting for fiduciary duty.<sup>62</sup> Delaware permits almost complete contracting, including the elimination of default fiduciary duties altogether.<sup>63</sup> By contrast, fiduciary duties are not subject to actual contracting in corporation law, not even tinkering along the margins;<sup>64</sup> corporate duties are mandatory and determined by the law.<sup>65</sup> If fiduciary duties are only a matter of contracting, one wonders why the law explicitly prohibits actual contracting in certain business forms and not others.<sup>66</sup> There must be an underlying policy.

Fiduciary duties are merely “contractual” gap-fillers in the minds of committed contractarians. That idea is merely a shared belief among some, but does not advance our understanding. It is an assertion. If one only sees the world through the prism transmogrifying associational assent with contract, then everything looks like a contract, real or imagined.<sup>67</sup> As the

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<sup>62</sup> E.g., DEL. CODE ANN., tit. 6, § 17-1101(c) (stating that the intent of the limited partnership statute is “to give maximum effect to the freedom of contract”), § 18-1101(b) (same for limited liability company statute); *NAF Hldgs., LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 180 n.14 (Del. 2015) (“Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties.”) (quoting *NACCO Indus. v. Applica Inc.*, 997 A.2d 1, 35 (Del. Ch. 2009)).

<sup>63</sup> DEL. CODE ANN., tit. 6, § 17-1101(d) (limited partnerships), § 18-1101(c) (limited liability companies).

<sup>64</sup> Almost all states permit the exculpation of personal liability for money damages, but such exculpation is exactly that and does not alter the nature or the scope of fiduciary duties. See DEL. CODE ANN., tit. 8, § 102(b)(7).

<sup>65</sup> See MOD. BUS. CORP. ACT § 7.32 cmt. (2020) (commenting that a shareholder agreement cannot “eliminate all of the standards of conduct”); *Sutherland v. Sutherland*, 2009 WL 857468, at \*4 (Del.Ch. 2009) (“While such a provision [eliminating fiduciary duty] is permissible [Delaware limited liability companies and limited partnerships] where freedom of contract is the guiding and overriding principle, it is expressly forbidden by the DGCL.”); *Williams v. 5300 Columbia Pike Corp.*, 891 F.Supp. 1169, 1183 n.30 (E.D. Va. 1995) (“Yet, a by-law amendment surely cannot eliminate directors’ fiduciary duty of loyalty and fairness to shareholders.”).

<sup>66</sup> Non-Delaware laws of partnerships and limited liability companies make a clear distinction, like Delaware, between contract fiduciary duties and mandatory fiduciary duties. See, e.g., REVISED UNIF. P’SHIP ACT § 103(b) (Unif. Law Comm’n 1997 and harmonized 2013) (permitting some degree of contracting for the fiduciary duties of care and loyalty, but not their elimination or “manifestly unreasonable” alteration).

<sup>67</sup> In fact, contractarianism can lead to stunning reductionism, for example: “It is meaningful to speak of . . . Congress . . . but it would be misleading to think of Congress — an entity with a name — only as an entity, or to believe that its status as an entity is the most

law stands, mandatory fiduciary duties function as intended, tossing the matter to courts to pass judgment on the equities of the conduct. It is neither here nor there to say that judges guess what the “contractual” gap-filler should be. It is a semantic play with words, a characterization of something that is not subject to verification with any confident measure. Their argument, often made in conjunction with an expressed concern over transaction cost, strikes of rationalization. This comment is not a diminishment of the very important analytical framework of transaction cost economics.<sup>68</sup> Rather, the thought here is that transaction cost analysis is sometimes plied in a way that may be just a policy preference, *i.e.*, the rumination on the “most efficient hypothetical contract term” according to the ruminator. Such arguments are hard to verify because the costs are too often abstractions whereas the argumentations are ultimately grounded in mathematical equalities and inequalities of cost-benefit analysis. This is not a demand for quantitative proof, but a calling out for strong qualitative showing that could verify with some confidence on argumentations that are otherwise quite abstract and ephemeral.

For example, it is possible to argue that corporations are different because the transaction cost associated with establishing a real contract, as actually seen in the world in partnership agreements, is said to be so high that fiduciary rules are mandatory, thus requiring “contractual gap-fillers” which is the more efficient way to doing things. This assertion is plausible, but ultimately facile. All sorts of matters are actually put to shareholders to vote or ratify, including a fiduciary’s conflict of interest transactions, and there is no real contract or transaction cost barrier to shareholder voting (a form of a more actual contract).<sup>69</sup> But such contracting, despite transaction cost feasibility, is a nonstarter in corporation law. The law prohibits actual contracting among shareholders and managers for contractual fiduciary duty.<sup>70</sup> The mandatory rule of fiduciary duty exists even when utmost procedural safeguards exist to ensure uncoerced, fully informed votes.

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significant thing about the institution.” EASTERBROOK & FISCHER, *supra* note 57, at 12. If one asserts that the only reality is associational assent of human relations, it would not be unfair characterization to conclude that contractarianism rejects the reality of things such as “entities” or “institutions” or even “nations.” The argument strikes of tautology.

<sup>68</sup> See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

<sup>69</sup> *E.g.*, DEL. CODE ANN., tit. 8, § 144(a)(2).

<sup>70</sup> *Supra* note 65.

Corporation law is clever in designing procedural safeguards to achieve uncoerced, fully informed shareholder consent.<sup>71</sup>

Perhaps the simpler explanation for why fiduciary duty in corporation law is mandatory, despite the easy feasibility of such contracting from the view of procedure and transaction costs, is that it would be a terrible idea. In noncorporate entities, the consequence of the idea is limited because the social cost of mishaps is relatively low in light of the generally smaller firms and the closer monitoring in smaller firms. Some degree of permissive contracting makes sense because these firms are more contract-like than corporations, which are less like actual contract (the “nexus of contracts” idea notwithstanding) and more like association of assenting persons, the latter of which is just trivially obvious. Mishaps in corporations are another matter altogether. Contracting for corporate fiduciary duties would recklessly endanger the value inherent in the public equity markets and have the real potential for catastrophes that erode public trust, a theory of contractualism notwithstanding. But Easterbrook and Fischel suggest this.<sup>72</sup> One anecdotal response is the case of Enron and the critical role of permitted (*i.e.*, contracted for) self-dealing by fiduciaries therein.

In light of the laws of business organizations (and contracts), the preoccupation with hypothetical contractual gap-filling is odd. In laws, there are real contractual gap-fillers, *i.e.*, the implied obligation of good faith and fair dealing.<sup>73</sup> No law permits the elimination of this real contractual gap-filler as that would be non sequitur.<sup>74</sup> Delaware courts and most other

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<sup>71</sup> *E.g.*, Kahn v. M & F. Worldwide Corp., 88 A.3d 635, 645 (Del. 2014) (stating the conditions in which a controlling shareholder cash out transaction is uncoerced and fully informed); Air Products and Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48, 54, 106 (Del.Ch. 2011) (ruling that transaction structure ensured that shareholders were fully informed and structurally uncoerced).

<sup>72</sup> “Should the corporation develop a particular product or allow a manager to form a separate corporation to exploit the opportunity? . . . These are more tractable questions, on which voluntary transactions are preferable to judicial guesses.” Easterbrook & Fischel, *supra* note 57, at 445.

<sup>73</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); REVISED UNIF. P’SHIP ACT § 404(d) (Unif. Law Comm’n 1997 and harmonized 2013); REVISED UNIF. LTD. LIAB. CO. ACT § 409(d) (Unif. Law Comm’n 2006 and harmonized 2013); UNIF. LTD. P’SHIP ACT § 408(d) (Unif. Law Comm’n 2001 and harmonized 2013)

<sup>74</sup> Even Delaware, which permits complete elimination of fiduciary duties (*supra* note 63) mandates that the obligation of good faith and fair dealing cannot be waived. See DEL.

business organization laws have clearly distinguished this real contractual gap-filler from the fiduciary principle.<sup>75</sup> In most states, the fiduciary principle is a mandatory rule subject to some contracting for noncorporate entities; it is not a default rule subject to complete contracting. At least one court has called fiduciary duties “equitable gap-fillers,” and others have called them “equitable torts,” the operative word being *equitable* and thus subject to the court’s exclusive judgment of equity.<sup>76</sup> Easterbrook and Fischel’s argument does not engage existing law as a substantial point of consideration and reality; their underlying premise is that all associational assent, which describes all human relations post-nineteenth century, reduces to contract, real or imagined.<sup>77</sup> There is no ground under Easterbrook and Fischel’s argument. For the most part, scholars of fiduciary

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CODE ANN., tit. 6, § 17-1101(d) (“the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing”); *id.* § 18-1101(c) (“the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing”).

<sup>75</sup> See *Gerber v. Enterprise Prods. Holdings, LLC*, 67 A.3d 400, 418 (Del. 2013) (distinguishing the implied covenant of good faith from “a fiduciary duty or tort analysis”), overruled on other grounds by *Winshall v. Viacom Int’l, Inc.*, 76 A.3d 808, 815 (Del. 2013); *Dieckman v. Regency GP LP*, 155 A.3d 358, 366-67 (Del. 2017) (noting that while fiduciary duties may be contractually eliminated in a Delaware limited partnership, the contractual obligation of good faith and fair dealing cannot); See, e.g., REVISED UNIF. P’SHIP ACT § 103(b) (Unif. Law Comm’n 1997 and harmonized 2013) (prohibiting the elimination of good faith and fair dealing), § 404(a), (d) (distinguishing between fiduciary “duty” and the “obligation” of good faith and fair dealing); Daniel Markovits, *Sharing Ex Ante and Share Ex Post*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 215-17 (distinguishing between the contractual obligation of good faith and fiduciary duties of care and loyalty).

<sup>76</sup> See *Auriga Capital Corp. v. Gatz Properties*, 40 A.3d 839, 853 (Del.Ch. 2012) (“equitable gap-filler”); *In re Rural Metro Corp.*, 88 A.3d 54, 98 (Del. Ch. 2014) (“equitable tort”); *Hampshire Gp., Ltd. v. Kuttner*, 2010 WL 2739995, at \*54 (Del. Ch. 2010) (“equitable tort”); *Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180, 1211 (Del. Ch. 2010) (“equitable tort”). See also J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 71 (2010) (noting that “a breach of a fiduciary duty is in fact a tort, although a unique species historically called an ‘equitable tort’”); Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139, 1143 (2013) (“Tort theory provides not just the lexicon of liability, but the foundational principles of the duty and liability of corporate boards.”).

<sup>77</sup> See Markovits, *supra* note 75 (commenting that the contractarian model reflects “its presumptions and preoccupations”); Richard R.W. Brooks, *Knowledge in Fiduciary Relations*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 225 (“Equating consent with contract is an obvious overreach. . . . Departing from an incomplete contracts perspective, there is an overwhelming tendency to view everything that follows as contract.”).

law have rejected the assertion that the fiduciary principle is simply a form of contract and does not exist as an independent doctrine.<sup>78</sup>

Other scholars with an economic bent have more grounded in law and easier to grasp policies. Some argue that the underlying policy concern is optimal deterrence of social cost, the same policy governing tort law in an economist's eye. Robert Cooter and Bradley Freedman argue that the fiduciary principle corrects two types of wrongs, misappropriation (an act of malfeasance), and neglect (an act of nonfeasance).<sup>79</sup> Avoiding these wrongs, they argue, go to the core of the fiduciary's duty of loyalty and the duty of care. Robert Sitkoff also argues that "the functional core of fiduciary obligation is *deterrence*."<sup>80</sup> He attempts to fit a contractarian approach with the reality of existing law. While asserting that fiduciary law consists mostly of default rules subject to contracting, he acknowledges the reality of mandatory rules.<sup>81</sup> Mandatory rules serve a cautionary function: "the

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<sup>78</sup> See Miller, *supra* note 5, at 252, 282 ("Easterbrook and Fischel's assertion is just that, but it presents bracing challenge. . . . However, the notion that there is nothing distinctive about the duty is wrong."); Smith, *supra* note 13, at 1428 ("This account glosses over the fact that incomplete contracts are ubiquitous, but fiduciary duties are imposed only in a subset of those relationships."); Hanoch Dagan & Sharon Hannes, *Managing Our Money: The Law of Financial Fiduciaries as a Private Law Institution*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 5, at 101 ("And yet this canonical economic analysis, which insists that there is nothing special ('there is no subject') to a fiduciary relationship, is disappointing."); Sitkoff, *supra* note 61, at 198, 205 (noting that contractarians "have had difficulty in explaining why the parties to a fiduciary relationship do not have complete freedom of contract. . . . Easterbrook and Fischel went so far as to assert, erroneously, that in trust law '[a]ll rules are freely variable by contract in advance'"); Markovits, *supra* note 75, at 210 ("Fiduciary law thus cannot be *understood* on the contractarian model. Understanding fiduciary law requires a model besides contract.") (emphasis in original); Leib, *supra* note 4, at 685 (stating that Easterbrook and Fischel ignore the empirical observation that courts view the fiduciary principle through a moral framework).

<sup>79</sup> Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1047 (1991).

<sup>80</sup> Sitkoff, *supra* note 61, at 201 (emphasis in original).

<sup>81</sup> *Id.* at 204-05. "Generally speaking, fiduciary duties yield to a contrary agreement of the parties." *Id.* at 204. This general assertion finds much support in the law. The laws of business organizations, *sans* corporation law, permit much contracting. *Supra* notes 62-63 and accompanying text. Courts have held that when a contract claim is the parties' dispute, a fiduciary claim is superfluous. See *In re Zohar III, Corp.*, 631 B.R. 133, 178 (D. Del. Bankr. 2021) ("Generally, [u]nder Delaware law, if the contract claim addresses the alleged wrongdoing ..., any fiduciary duty claim arising out of the same conduct is

mandatory core insulates fiduciary obligations that the law assumes would not be bargained away by a fully informed, sophisticated principal.”<sup>82</sup> This analysis uses the oft-applied method of the hypothetical contractual bargain.

The majority of commentators have focused on the elements of a fiduciary relationship. The most widely accepted theory seems to be that discretionary authority is the core element of a fiduciary relationship.<sup>83</sup> Ernest Weinrib states: “First, the fiduciary must have scope for the exercise of discretion, and second, this discretion must be capable of affecting the legal position of the principal.”<sup>84</sup> Paul Miller advances a fiduciary power theory: “a fiduciary relationship is one in which one party (the fiduciary) enjoys discretionary power over the significant practical interests of another (the beneficiary).”<sup>85</sup> He emphasizes power as the core element,<sup>86</sup> and power is best understood as discretionary authority rooted in the structure of the relationship, and not simply influence situationally seen under the circumstance.<sup>87</sup> Tamar Frankel has identified discretionary power as the core element of a fiduciary relationship: “the fiduciary serves as a substitute for the entrustor . . . [and] the fiduciary obtains power from the entrustor or

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superfluous. This policy is in place to protect the primacy of contract law over fiduciary law in matters involving ... contractual rights and obligations.”) (internal quotation marks omitted and quoting *Grayson v. Imagination Station, Inc.*, 2010 WL 3221951, \*7 (Del.Ch. 2010)).

<sup>82</sup> *Id.* at 205.

<sup>83</sup> See Gold, *supra* note 25, at 36-37 (“Leading theories of fiduciary relationships take discretion to be a fundamental component of the relationship.”) (citing works of Gordon Smith, Paul Miller, Ernest Weinrib); Laby, *supra* note 5, at 987 (“The dominant view held by fiduciary scholars, however, is that discretion is an essential component of fiduciary relationships.”).

<sup>84</sup> Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975).

<sup>85</sup> Miller, *supra* note 5, at 262 (emphasis removed). See Miller, *supra* note 12, at 69 (same).

<sup>86</sup> “The most significant of [the definitive properties] is, unsurprisingly, the exercise of *power* by the fiduciary relative to the beneficiary. It is commonly suggested that fiduciaries possess power over others.” Miller, *supra* note 12, at 69 (emphasis in original).

<sup>87</sup> Miller, *supra* note 5, at 273-74. See Miller, *supra* note 12, at 70 (“[F]iduciary power is distinguishable from other varieties of power by virtue of the fact that it is a form of *authority* ordinarily derived from *legal personality* of another (natural or artificial) person.”) (emphasis in original).



from a third party for the sole purpose of enabling the fiduciary to act effectively.”<sup>88</sup>

A theory based on discretionary authority confronts a doctrinal incongruity. Courts routinely find that one can be a fiduciary without such power, such as when she acts in an advisory capacity.<sup>89</sup> Miller argues that “advisers are not fiduciaries as such . . . advisers are not fiduciaries by virtue of giving advice,” but finesses the issue by making a small exception: “Save for the rare circumstance in which the advisee is so epistemically dependent on the adviser that he is incapable of exercising independent judgment in determining how to act in reliance on the advice.”<sup>90</sup> In this exception, the adviser enjoy “*effective* discretionary power over the advisee.”<sup>91</sup> Some scholars have criticized this view by noting that the law recognizes fiduciaries even when they lack discretionary authority. For example, lawyers, money managers, doctors, and advisers may lack discretionary authority, but are routinely held to be fiduciaries. “The challenge is thus a challenge of doctrinal fit—on this view, the epistemic dependence argument does not match up to a sufficient percentage of cases (or of the core cases) to make it a satisfactory interpretive account.”<sup>92</sup>

Some scholars place the locus of a fiduciary relationships elsewhere. Evan Criddle argues that the fiduciary principle is a prophylactic against abuse of power. He incorporates a political rationale for fiduciary law. A republican theory of fiduciary law prescribes that anti-domination is the

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<sup>88</sup> Frankel, *supra* note 13, at 808-09. She defines “power” to mean “an ability to make changes that affect the entrustor.” *Id.* at 809 n.47. See TAMAR FRANKEL, *FIDUCIARY LAW* 6 (2011) (providing that fiduciary relationships exhibit four characteristics: (1) fiduciaries “offer mainly services”; (2) they are “entrusted with property or power”; (3) beneficiaries bear the “risks that fiduciaries will not be trustworthy”; (4) there is a likelihood that the beneficiaries will be harmed or the fiduciaries bear exorbitant of proving trustworthiness). Other commentators have focused on the endowed power of a fiduciary with the ability and the duty to advance the interest of the beneficiary. See SHEPHERD, *supra* note 56, at 96 (“A fiduciary relationship exists whenever any person acquires a power of any type on condition that he also receive with it a duty to utilize that power in the best interests of another, and the recipient of the power uses that power.”)

<sup>89</sup> See Gold, *supra* note 25, at 37.

<sup>90</sup> Miller, *supra* note 12, at 84 & n.76.

<sup>91</sup> *Id.* (emphasis in original).

<sup>92</sup> Gold, *supra* note 25, at 39. See Laby, *supra* note 5, at 955 (“Business advisors, investment advisors, lawyers, physicians, and others are often deemed fiduciaries, although they lack discretionary authority.”).

core element of the fiduciary relationship.<sup>93</sup> Republicanism embraces the normative value of freedom from domination.<sup>94</sup> The test to determine whether a fiduciary relationship exists or not is the following: “Fiduciary duties apply whenever a party has been entrusted with power over another’s legal or practical interest.”<sup>95</sup> Fiduciary law empowers principals while also emancipating principals, beneficiaries, and fiduciaries from domination.<sup>96</sup>

Another locus of a fiduciary relationship has been identified as the interest belonging to the beneficiary. Gordon Smith advances a theory of fiduciary law that emphasizes the interest at stake: “fiduciary relationships form when one party (the ‘fiduciary’) acts on behalf of another party (the ‘beneficiary’) while exercising discretion with respect to a *critical resource* belonging to the beneficiary.”<sup>97</sup> The “crucial resource” element is the most innovative contribution of his theory.<sup>98</sup> “The important point is that *something* lies at the core of the fiduciary relationship and binds the fiduciary to the beneficiary.”<sup>99</sup> A critical resource is a more expansive concept than just property and may encompass property or right, tangible or intangible.<sup>100</sup> The most important class of critical resource is confidential information.<sup>101</sup>

## II. THE LIBERAL THEORY AND ELEMENTS

### A. Statement of Theory

A positive theory must explain ad hoc fact-based fiduciary relationships, which are commonly seen in the law but still represent a

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<sup>93</sup> Criddle, *supra* note 5, at 995, 997.

<sup>94</sup> *Id.* at 1024.

<sup>95</sup> *Id.* at 1000 (emphasis removed).

<sup>96</sup> *Id.* at 1025.

<sup>97</sup> Smith, *supra* note 13, at 1402 (emphasis removed and in original).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 1404 (emphasis in original).

<sup>100</sup> *Id.* at 1444. “The term ‘critical resource’ is introduced here to avoid the pitfalls associated with relying on the legal concept of ‘property.’” *Id.* at 1404.

<sup>101</sup> *Id.* at 1445. See Criddle, *supra* note 5, at 1040 (“An increasingly important type of de facto power that may generate fiduciary duties is access to confidential information.”).

sliver of all fiduciary relationships. On this measure, a positive theory based on discretionary authority, the most widely accepted concept, comes up short. Because ad hoc fact-based relationships are a minor part of the whole, they could be easily discounted. Sometimes incongruous data are just that; but sometimes they are a calling. I take the latter view in this subject. If a theory explains ad hoc relationships as a part of a principled whole, it can reveal the general working of the fiduciary principle. The inspiration is the scientific method: If a theory does not match confirmed observation, then the theory is either wrong or incomplete.<sup>102</sup> As in the sciences, seemingly stray, incongruous data sometimes present an opportunity to devise a better theory if minor incongruities can reveal the inner working of the underlying principle. Ad hoc fact-based relationships fit within a unified framework of fiduciary law that explains all fiduciary relationships.<sup>103</sup>

It is clear that a theory based on observable facts of trust, confidence, vulnerability, or even power disparity alone, is built on sand. These concepts necessarily require line drawing and definitional finessing that would ultimately seem ad hoc or unsatisfying. Our understanding is better off by not relying on the rhetoric of “trust, confidence, and vulnerability.” These observable facts are emanations of a fiduciary relationship, but are

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<sup>102</sup> Perhaps the most famous instance in all of science in which incongruous data was instrumental to the development of a theory is Albert Einstein’s general theory of relativity. Prior to Einstein’s theory, Newtonian physics explained the orbits of all planets, except Mercury whose orbit was oddly incongruous with classical mechanics. The general theory of relativity explained the motions of all planets including the unique orbit of Mercury. See ALBERT EINSTEIN, *RELATIVITY: THE SPECIAL AND THE GENERAL THEORY* 103 (1961). The confirmation of Mercury’s orbit under the new theory gave Einstein heart palpitations. Jagdish Mehra, *The Calculations that Gave Einstein “Heart Palpitations”*, 11 *FOUNDATIONS OF PHYSICS LETTERS* 391 (1998).

<sup>103</sup> Shepherd set forth nine characteristics that a unified theory should exhibit. Summarized, they are: (1) legal principle stated in a usable form for courts; (2) natural congruence with the moral sentiments of the equitable approach; (3) an explanation of reliance, good faith, and vulnerability of beneficiaries; (4) flexibility to adjust to diverse commercial realities and circumstances; (5) flexibility of standards depending on the relationship; (6) focus on the structure of the relationship rather than the unique relationship between parties; (7) fiduciary duty flowing from the theoretical framework; (8) imposition of fiduciary obligation on only those who actually have power over another; (9) identification of a proprietary interest or property right. SHEPHERD, *supra* note 56, at 94-95. I agree that a unified theory should exhibit these characteristics.

not elemental. The liberal theory of fiduciary law focuses on the structure of relationships that typically produce these observable byproducts.<sup>104</sup>

The liberal theory states that a fiduciary relationship arises when: (1) power exists in a relationship, (2) power exists in a systemic and structural state, termed here *systructural*,<sup>105</sup> such that it creates articulable, easy to intuit classes or categories of relationships or types of dealings, (3) systructural power relation negates an initial strong presumption of equal footing in human and commercial dealings in a liberal society whose first principle is autonomy, human agency, and law's noninterference in private affairs, and (4) systructural power is exerted against critical interests, which are recognized interests in a liberal, capitalist society determined to be so important that the law intervenes in otherwise private affairs to protect them, such as money and wealth, wellbeing of body and mind, and other rights-based interests.

This theory starts from the common question that is asked when justifying a rule: What problem is the rule seeking to solve? The instrument function of the liberal theory is to equalize a relationship that cannot be equalized due to systructural power and the interest at stake is socially vital. To permit private ordering, the capacity for equal footing is a conditional presumption of the law. When that presumption does not hold, neither autonomy nor human agency can hold either. This instrumental function of the fiduciary principle justifies the law's intervention into private affairs and imposition of a moral-based code of conduct. The liberal theory has a political economic foundation. The liberal theory is called as such because it is grounded in the idea that fiduciary law should not conflict with the core values of a liberal society with a strong market system governing economic transactions. The theory harmonizes the tension between, on the one hand,

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<sup>104</sup> The theoretical irrelevance of "trust, confidence, and vulnerability" is demonstrated by the fact that in the rest of the discussion and analysis that follow this article make very little mention of these factors.

<sup>105</sup> *Systructural* is a neologism that fits the definitional need here. The English language does not have a single word to connote the dual qualities of "systemic" and "structural." My neologism is a useful contraction of "systemic and structural" or "systemic-structural." To my scrivener's sensibilities, repetitive use of these two terms in conjunction seems cumbersome. The concept of systructural power may have application in other areas of law. For example, one can make a case that racism is both systemic and structural. E.g., Mario L. Barnes & Erwin Chemerinsky, *What Can Brown Do for You?: Addressing McClenskey v. Kemp as a Flawed Standard for Measuring the Constitutionally Significant Risk of Race Bias*, 112 NW. U.L. REV. 1293, 1301 (2018) (noting "the operation of unconscious bias and structural or systemic forms of racism").

autonomy, private ordering, and law's noninterference, and on the other hand, incapacity of equal footing, systructural power disparity, and risk to socially vital interests.

## B. First Element: Extant Power and Power's Nature

The first element of a fiduciary relationship is the existence of power. Power is a universal feature of a fiduciary relationship.<sup>106</sup> If a person has no power over another, there is no basis to impose fiduciary obligations. All courts and commentators acknowledge the condition of power. But commentators differ on the nature of power. Some limit power to formal, *de jure* power, which is discretionary authority.<sup>107</sup> This form of power adheres to the definition of power as a legal concept.<sup>108</sup> Although this is the dominant view,<sup>109</sup> this conception of power has been criticized on the ground that case law consistently finds a fiduciary relationship when the fiduciary is merely an adviser or a holder of confidential information.<sup>110</sup> The data is incongruous with the prevailing theory.

The liberal theory of fiduciary law embraces a broader concept of power. Power is defined as any trait of coercive influence on a person.<sup>111</sup>

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<sup>106</sup> See Criddle, *supra* note 16, at 108 ("Has power been committed to a party under an other-regarding or purposeful mandate, such that the power holder is not entitled to determine unilaterally how the power will be exercised? If the answer to this question is yes, fiduciary duties apply to the relationship."); Miller, *supra* note 12, at 69 (noting that power is the most significant" element in a fiduciary relationship). The academic theory of a fiduciary relationship is based on discretionary power. See *supra* note 83.

<sup>107</sup> See Weinrib, *supra* note 84, at 4 ("First, the fiduciary must have scope for the exercise of discretion, and, second, this discretion must be capable of affecting the legal position of the principal."); Frankel, *supra* note 13, at 809 n.47 ("The term 'power' here means an ability to make changes that affect the entrustor.").

<sup>108</sup> Power is defined as "legal ability, capacity or authority to act; delegated authority; authorization, commission; legal authority vested in a person or persons in a particular capacity." *Power*, OXFORD ENGLISH DICTIONARY, <https://www.oed.com/view/Entry/149167?rskey=mP9aSh&result=1#eid> (last visited May 12, 2022).

<sup>109</sup> See *supra* note 83.

<sup>110</sup> See Criddle, *supra* note 5, at 1035-36; Laby, *supra* note 5, at 986-89.

<sup>111</sup> See Miller, *supra* note 12, at 70 ("Power may mean control, authority, strength, or influence, amongst other things.").

This is a general definition of power, less specific and legalistic.<sup>112</sup> The simplest, clearest form of power is formal authority. Power derives from clear authority of some sort, per contract or law.<sup>113</sup> But power comes in other forms. Any set of circumstance can result in one having coercive influence over another.

Hierarchy in any social relation creates power. It is seen in all facets of society: *e.g.*, supervisor-subordinate, adviser-advisee, coach-player, parent-child, customer-business (and vice versa), business-supplier (and vice versa), teacher-student, etc. One initially intuitively feels that the weaker of the two in a power relation is owed fiduciary duty, but that is not always true. A principal-agent relationship is a hierarchical relationship because the principal has control of the agent.<sup>114</sup> Yet it is the agent who owes fiduciary duty because she has the power of discretionary authority to change legal relation on behalf of the principal.<sup>115</sup>

Knowledge creates power.<sup>116</sup> Advantage of knowledge can take the form of a specialized field or information asymmetry. When advice is sought, there is trust, explaining the existence of vulnerability; when advice is needed, there is a disparity in knowledge, explaining the need for consultation. Power here is not merely the pull of suasion, but the push of compunction. It can arise from any relationship when there is vulnerability. Trust, vulnerability, and unequal standing in hierarchy or knowledge can

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<sup>112</sup> Power is defined as “ability to act or affect something strongly . . . capacity to direct or influence the behaviour of others; personal or social influence.” *Power*, OXFORD ENGLISH DICTIONARY, <https://www.oed.com/view/Entry/149167?rskey=mP9aSh&result=1#eid> (last visited May 12, 2022). *Cf. supra* note 108 (defining “power” as a legal concept).

<sup>113</sup> *E.g.*, *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 which are controlled by no other specific duty imposed by the trust instrument or the legal regime.”); REVISED UNIF. P’SHIP ACT § 401(f)-(g) (Unif. Law Comm’n 1997 and harmonized 2013) (“Each partner has equal rights in the management and conduct of the partnership business. A partner may use or possess partnership property only on behalf of the partnership.”).

<sup>114</sup> See RESTATEMENT (THIRD) OF AGENCY § 1.01 (2005) (stating that an agent is “subject to the principal’s control”).

<sup>115</sup> *Id.* § 3.01 (actual authority to bind principal), § 3.03 (apparent authority to bind principal).

<sup>116</sup> See *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992) (noting that “knowledge and expertise” can create a fiduciary relationship but also not “every expert is automatically a fiduciary”). Francis Bacon’s aphorism “knowledge is power” is apt here. John Bartlett, *Familiar Quotations* 10 (10th ed. 1919) (attributing quotation to Francis Bacon, *Meditationes Sacrae* (1597)).

enable a power structure in a relationship. In other words, these factors are frequently cited in courts and commentary because power is a condition of a fiduciary relationship.

Knowledge is the source of power when an adviser lacks discretionary authority, but is still found to be a fiduciary.<sup>117</sup> Professionals such as doctors, lawyers, accountants, investment advisers, and investment bankers have specialized knowledge and often in informationally asymmetric positions relative to clients. Their advice is sometimes necessary. They have coercive power. The dictionary definition of coercion is “constraint, restraint, compulsion; the application of force to control the action of a voluntary agent.”<sup>118</sup> A felt compunction is apt here.<sup>119</sup> In this sense, power is not always associated with the negative sentiment of being under threat, but is associated with some applicable force. One can be coerced to follow advice, albeit freely rejectable, because one feels compelled to follow it.<sup>120</sup> The advice of lawyers and investment bankers are necessary in many corporate transactions. An investment banker’s fairness opinion is not strictly necessary, but an opinion that the transaction is unfair from a financial point of view is damning. Only doctors can give medical advice and

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<sup>117</sup> See McLeod & Ryman, *supra* note 38, at 76 (suggesting that knowledge and skill are sources of a fiduciary’s power). See also Brooks, *supra* note 77, at 228 (“Fiduciaries are almost always hired for some skill, expertise, or technical knowledge, which is seldom reducible to very specific language in contracts.”).

<sup>118</sup> *Coercion*, OXFORD ENGLISH DICTIONARY, <https://www.oed.com/view/Entry/35725?redirectedFrom=coercion#eid> (last visited May 10, 2022).

<sup>119</sup> Some commentators fit this type of power into a framework of discretionary authority. See Gold, *supra* note 25, at 39 (“[S]ometimes an individual will be so dependent on an adviser that they can’t exercise independent judgment; the result is that the adviser has a de facto discretionary power.”); Miller, *supra* note 12, at 84 n.76 (noting that in cases of “total reliance the adviser enjoys *effective* discretionary power over the advisee”). As Shakespeare said, a rose is still a rose. Coercive power or de facto/effective discretionary power—they refer to the same concept that a person has power. I prefer the generality of coercion as opposed to discretionary power because the formal decisionmaking resides with the beneficiary in these cases.

<sup>120</sup> See Criddle, *supra* note 5, at 1037 (“Fiduciary power is a form of authority. It may be de jure or de facto. . . . A fiduciary’s holds de facto power if she is in a position, as a practical matter, to dictate how another’s legal rights or powers will be exercised (e.g., investment adviser).”).

perform procedures requiring informed consent.<sup>121</sup> Medical patients get a second opinion, not because they wish to disregard a doctor's advice but because they want the best opinion for the purpose of following advice. Clients are always free to reject the advice, but often feel compelled to listen and follow because rejection can be consequential.

The first condition of a fiduciary relationship is the existence of power in some form that can be exerted against another. Relationships without discretionary authority can be fiduciary. A theory must explain the nature of power in all fiduciary relationships. Power as defined here—any trait of coercive influence on person—is universal.<sup>122</sup> Hierarchy and disparity in knowledge, information, and expertise are universal. How should we sort these different kinds of power relations? Unless constrained, the concept of power as an observation of the unique structure of any relationship is an unworkable concept. The only constraint would be an unmoored decisionmaking by courts. Understandably, this problem is probably why some commentators define power narrowly, thus the fiduciary relationship as well, to only situations involving discretionary authority, the clearest and uncontroversial form of power.<sup>123</sup> But this is not the law.<sup>124</sup> It ignores incongruous data. For a theory of fiduciary law to work, power must be a condition, but it must also be conditioned.

### C. Second Element: Systructural Power

The second element of a fiduciary relationship is the condition that power must exist in a systructural state. Power must first be systemic.<sup>125</sup> It must pervasively exist in the broader society. While fact-based findings are

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<sup>121</sup> See Marc A. Rodwin, *Strains in the Fiduciary Metaphor: Divided Physician Loyalties and Obligations in a Changing Health Care System*, 21 AM. J.L. & MED. 241, 242, 247-48 (1995) (“the law holds doctors accountable as fiduciaries only in restricted situations . . . requiring that physicians not abandon patients, keep information they learn confidential, obtain patients’ informed consent to treatment, and . . . disclose to patients any financial interest in clinical research”).

<sup>122</sup> *Supra* note 112.

<sup>123</sup> *Supra* note 83-88.

<sup>124</sup> *Supra* note 89-92.

<sup>125</sup> “Systemic” is defined here as “relating to a system as a whole; inherent in the system.” *Systemic*, OXFORD ENGLISH DICTIONARY, <https://www.oed.com/view/Entry/196680?redirectedFrom=systemic#eid> (last visited May 9, 2022).



always unique to their facts, the cases have shared genes that group them in articulable, intuitive categories. Systemic power means that the particular application of power over the beneficiary or her interest must be seen on a persistent, pervasive basis so that we can intuit articulable classes of persons or types of dealings. The expected numerosity of classes or types indicates a social problem large enough to require legal intervention. A court could apply equity in true one-off unclassifiable cases if the facts are extreme enough, but the law could just as easily ignore these random cases, and few would notice.<sup>126</sup> Law is more likely to intervene with rules and rulings when problems are systemic. Thus, systemic power connotes the idea of numerosity or largeness even in cases of ad hoc fact-based fiduciary relationships.

Systemic power is insufficient. To see why, consider that hierarchy and systemic power relation in our world are universal. A business-customer and friendships, as classes of relationships go, are ubiquitous. Because there is numerosity, power relations therein are systemic. But the mere persistent, pervasive existence of hierarchies or power relations in certain classes of relationships cannot be the only dispositive element in the inquiry of power. The problem is that the orientation of the power relationship is random and thus not predictable.

Power must also be structural.<sup>127</sup> This quality of structure conveys the idea that a set of facts or conditions consistently fixes that relationship in a specific orientation of power. If systemic power conveys numerosity and pervasiveness, structural power conveys polarity and causality. A cause consistently fixes the polarity of power, and a fixed polarity results in predictability. Structural power permits an intuition of articulable classes of persons or types of dealings that are routinely seen. The set of facts or conditions can be as simple as laws granting specific powers, *e.g.*, partners, corporate directors, and trustees. It also can be specific, recurring situations in which advice is given, *e.g.*, business advisers, investment advisers, lawyers, accountants, and doctors.

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<sup>126</sup> See Rotman, *supra* note 3, at 935 (“While the protean character of fiduciary law facilitates its potential application to numerous individuals or circumstances, fiduciary law was never intended to apply to garden variety of cases.”).

<sup>127</sup> “Structural” is defined here as “of or relating to the arrangement and mutual relation of the parts or elements of a complex unity.” *Structural*, OXFORD ENGLISH DICTIONARY, <https://www.oed.com/view/Entry/191887?rskey=akqIZ9&result=2#eid> (last visited May 9, 2022).

Systemic power does not mean that it is also structural. Each set of facts and conditions may or may not result in a structural power relation. For example, consider the difference between these two circumstances: (1) a trusted confidant urges her vulnerable friend with reckless disregard to invest in the latest offering of a highly risky, newly created cryptocurrency; (2) an accountant with a longstanding professional relationship urges his vulnerable client to invest in his special purpose fund that acquires and monetizes certain alienable tax credits. In both cases, the power of coercive influence prevailed, and the person suffered devastating financial loss. The power of the trusted confidant is a much weaker case of structural power; one cannot say that power always exists in a specific orientation. *Ex ante*, one can easily foresee the vulnerable friend falling for the advice, or just as equally not. These situations are systemic in terms of numerosity, but are not structural. On the other hand, the power of the longstanding accountant, the basic facts in *Burdett v. Miller*, is a stronger case for structural power. One can easily foresee the vulnerable client always tending to stand subordinate in a specific orientation of power.

Power is an element of a fiduciary relationship, and it is conditioned on being systructural. Power must have the twin qualities of numerosity and polarity.<sup>128</sup> Virtually all cases of fiduciary relationship, enabled or created by contract, statute, or ad hoc case law, show the existence of systructural power. Trustees, partners, directors, officers, and advisers have power that is systemic, and that power exists in a structural polarity.

#### D. Third Element: Negation of Equal Footing

The third element of a fiduciary relationship is a set of facts or circumstance, often due to the nature of structural power, that negates equal footing. The word choice of *negation* is deliberate. A fiduciary relationship is not created because equal footing is *absent*. There must be negation.

Courts have identified the absence of arm's-length dealing and inability to monitor as a factor in the analysis. Absence typically indicates a disparate power relation; existence typically indicates parity. Courts have refused to recognize a fiduciary relationship when parties are deemed to be on equal footing due to arm's-length dealings, or more accurately the

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<sup>128</sup> See Smith, *supra* note 22, at 270 ("Fiduciary law presents a more systematic problem of potential opportunism that calls for more than a mere safety value.").

*capacity* for arm's-length dealing.<sup>129</sup> An important facet of arm's-length dealing is monitoring and diligence of vetting. The *Burdett* court noted that a fiduciary relationship can result because an agent has "expert knowledge the deployment of which the principal cannot monitor."<sup>130</sup> Most commercial relationships are arm's-length, deemed to be on equal footing, and thus are not fiduciary in nature.<sup>131</sup> The law has an initial strong presumption of arm's-length dealing, equal footing, and diligence of vetting. This explains why courts do not impose a fiduciary relationship merely because in fact disparity in power exists and arm's-length dealing, equal footing and diligence of vetting are absent. In most situations, the law presumes autonomy and responsibility in our choices of business and personal relations. It does not interfere to reverse bad decisions or outcomes.

Structural power actively negates the strong presumption of equal footing and diligence of vetting. Knowledge and expertise are structural barriers to equal footing. One can argue that a person can always reject an expert for another, but there are two problems with this power to reject: first, a person must know that the expert is not serving him well to do so, which presumes understanding and knowledge; second, as a matter of policy, we may not want a rule that incentivizes second or third or fourth opinions, always chasing the last opinion or suspicion. Mere absence of arm's-length dealing, equal footing, and diligence of vetting is not enough because a person is presumed to be autonomous. But structural power changes the equation. Because power is structural, human agency and autonomy cannot be presumed. The power has a fixed polarity, thus negating the presumption of equal footing.

#### E. Fourth Element: Critical Interest

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<sup>129</sup> *E.g.*, *Daktronics, Inc. v. McAfee*, 599 N.W.2d 358, 363 (S.D. 1999) (not recognizing a fiduciary relationship because counterparties "were not in a dependent position, lacking in mental acuity or business intelligence"). *See Criddle, supra* note 5, at 1041 (stating that commercial relationships are "presumptively arm's-length" and accordingly do not beget a fiduciary relationship); *Olcott Int'l & Co., Inc. v. Micro Data Base Sys., Inc.*, 793 N.E.2d 1063, 1073 (Ind.App. 2003) ("When two parties are involved in an arm's length, contractual arrangement, a fiduciary relationship may not be predicated on such an arrangement.").

<sup>130</sup> *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992).

<sup>131</sup> *See supra* Sections I.A. and I.B.

The fourth element of a fiduciary relationship is a critical interest. A fiduciary relationship exists because it serves a beneficiary, or more precisely her interest. Without some critical interest, one questions the need for a fiduciary principle. Easterbook and Fischel would be right in concluding that there is nothing to see here.<sup>132</sup> Personal autonomy, contract, and market principles—the libertarian vision of government negation—would suffice. However, fiduciary law (and other associated laws<sup>133</sup>) exist because certain interests are so critical that the law should intervene and stringently protect them subject to the satisfaction of other conditions.

Commentators have argued that an element of a fiduciary relationship is an important interest over which the fiduciary has power. Shepherd asserts that a unified theory of fiduciary law must incorporate “a sense of proprietary interests or property rights.”<sup>134</sup> Miller argues that power in a fiduciary relationship must be held over a “practical interest,” defining such interest as “a real, ascertainable matter of personality, welfare, or right in relation to which one person may be uniquely and materially susceptible to the exercise of authority of another.”<sup>135</sup> Criddle argues that a fiduciary relationship must concern “another person’s legal or practical interest.”<sup>136</sup> Smith centers his theory of a fiduciary relationship on the existence of a “critical resource.”<sup>137</sup>

Commentators are right to intuit that the fiduciary relationship is created for the benefit of the beneficiary and that benefit is some *thing*. That thing is the purpose of the fiduciary relationship. The basic idea is that a fiduciary relationship is created to serve an important interest. Certain relationships may have structural power that negates equal footing, but may not be fiduciary in nature. For example, we do not ordinarily think of

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<sup>132</sup> See *supra* note 60 and accompanying text.

<sup>133</sup> For example, a fiduciary rule may be embedded in a larger law providing for guardianship, management of money, operation of businesses, etc. *E.g.*, Employee Retirement Income Security Act of 1974 (ERISA) § 3(21)(A), 29 U.S.C. § 1002(21)(A) (2018) (defining fiduciary with respect to an ERISA plan).

<sup>134</sup> SHEPHERD, *supra* note 56, at 95.

<sup>135</sup> Miller, *supra* note 5, at 276. See Miller, *supra* note 12, at 73 (“*Practical interests* include matters of personality, welfare, or right pertaining to persons or their causes.”) (emphasis in original).

<sup>136</sup> Criddle, *supra* note 5, at 1037.

<sup>137</sup> Smith, *supra* note 5, at 1444 (“a more expansive concept than ‘property’”). See Smith, *supra* note 22, at 279 (noting the importance of a “critical resource” and citing Gordon Smith, *supra* note 5).

coach-player or teacher-student relationships as being fiduciary despite the existence of a systructural power and negation of equal footing. The underlying interest that connects these parties are not deemed to be sufficiently critical for the law to intervene in the relationship. Under the liberal theory, there are three important aspects of a critical interest.<sup>138</sup>

First, an obvious point but worth spelling out, a critical interest must be distinct from mere subjective importance. All sorts of personal matters and affairs, no matter how subjectively important, can be honored or betrayed in everyday life, but may not qualify as critical interests. Subjective importance of an interest is not enough.

Second, *critical* connotes an important interest recognized and protected by law. The descriptive could just as easily have been called “protected” or “fundamental” interest, though these terms may confuse through their link to constitutional law. The point is that the law recognizes an interest as being critically important. Thus, a critical interest belongs to a class of interest that the law requires protection.

Third, the criticality of an interest is not a discrete, independent state. It can be a function of the relationships that connect to it. In other words, the same thing can be deemed to be critical or not depending on the relations that connect to it. A friend’s or business associate’s trusted advice on matters of finance or business does not beget a fiduciary relationship despite a betrayal of trust and devastating consequences on money and wealth, which are unquestionably important interests. One way to view at this outcome is to say that the person does not hold structural power. Another view is that, while money and wealth may be critical interests in the abstract, they are not critical interests when held in the specific relationship in question. The views are two sides of the same coin.

What, then, are critical interests? Judgment calls must be and have been made. Observations derive the rule. Indubitably, money and wealth of a person handled in a systructural power relation are critical interests. As a matter of observation, society has drawn this line clearly, and it needs little defense. Trillions of dollars are held by or managed under fiduciaries.<sup>139</sup> It could be that a majority of the wealth of Americans are

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<sup>138</sup> My word choice of a “critical interest” as opposed to Smith’s “critical resource” is to some extent a lexical preference. But I also note that “interest” connotes such things as rights and wellbeing, while in my mind “resource” connotes things that are more economic in nature, though Smith may not have constrained his definition in this way.

<sup>139</sup> See *infra* note 175.

wrapped at some level in the protection of fiduciary law.<sup>140</sup> Money and wealth are the focus of the fiduciary duties of trustees, partners, directors, officers, investment advisers, and institutions.

There are other forms of critical interest, such as physical or mental wellbeing in the context of a formal stewardship setting and rights-based interests, which explains the imposition of fiduciary duty on doctors, lawyers, guardians, and parents.<sup>141</sup> With respect to these interests, the law has recognized them as subjects of protection under the fiduciary concept. An example is *Moore v. Regents of University of California*.<sup>142</sup> The court held that a doctor owed a fiduciary duty to a patient with respect to obtaining informed consent.<sup>143</sup> Informed consent, of course, deal with the interest in the autonomy of one's body and wellbeing.<sup>144</sup> In this case, the doctors failed to disclose their personal interest in the patient's body parts including the potentially massive wealth that could be derived from them.<sup>145</sup> The critical interests at stake in this case are apparent.

### III. POLITICAL ECONOMIC FOUNDATION OF THE LIBERTY THEORY

#### A. In Liberalism's Eye

In most fiduciary relationships, parties voluntarily enter into fiduciary relationships with longstanding rules that over the course of time have been internalized as correct and expected. Although some may object to the

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<sup>140</sup> See *infra* Section III.B.

<sup>141</sup> E.g., *Hahn v. Mirda*, 54 Cal. Rptr.3d 527, 532 (App. 2007) (doctor); *Johnson v. Cofer*, 113 S.W.2d 963, 965 (Tex. App. 1938) (lawyer); *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992) (guardian). See generally Elizabeth S. Scott & Robert E. Scott, *Parents as Fiduciaries*, 81 VA. L. REV. 2401 (1995) (discussing parents); Lionel Smith, *Parenthood is a Fiduciary Relationship*, 70 U. TORONTO L.J. 395 (2020) (same).

<sup>142</sup> 793 P.2d 479 (Cal. 1990) (in bank).

<sup>143</sup> *Id.* at 483-85.

<sup>144</sup> *Id.* at 485 ("But California law does not grant physicians unlimited discretion to decide what to disclose. Instead, it is the prerogative of the patient, not the physician, to determine for himself the direction in which he believes his interests lie. Unlimited discretion in the physician is irreconcilable with the basic right of the patient to make the ultimate informed decision.") (internal quotation marks and citation omitted).

<sup>145</sup> *Id.* at 482-83.

mandatory nature of fiduciary law's code of conduct,<sup>146</sup> contract and assent control since fiduciaries know what they are getting into and what is required of them. Status- and contract-based fiduciary relationships are time tested, well accepted, and assented to, often per actual contract. We are not troubled at the instrumental level.

However, at the theoretical level, fiduciary law is in real tension with liberalism, the philosophical system of our political organization.<sup>147</sup> Absent a theory of fiduciary law, the tension is palpable. This perceived conflict is the animating animus of the contractarian objection.<sup>148</sup> Contract reflects freedom to order private affairs; mandatory fiduciary rules are the law's intervention. Fiduciary law could be rightly seen as legal paternalism.<sup>149</sup> An important issue is the harmonization of paternalism and autonomy.<sup>150</sup> A liberal society is one that values freedom, autonomy, and human agency, and the footprint of government is reduced to fit these values. We live in a liberal society where, as a purely quantitative matter, laws do not figure much in mandating moral and acceptable conduct in social and professional relations. The law does not intrude into private affairs absent good necessity. Contract law does not intervene to rescue parties from bad deals.<sup>151</sup> Tort

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<sup>146</sup> See *supra* Section I.C., notes 57-78 and accompanying text (discussing Easterbrook and Fischel's idea of relegating all of fiduciary law into a corner of contract law); *supra* note 184 (discussing Larry Ribstein's idea of denying fiduciary duty of partners based on status and in favor of contracting and circumstance specific imposition of fiduciary duty).

<sup>147</sup> Commentators have generally not set the fiduciary principle in the large scheme of political and economic systems, or at least sufficiently. There are notable exceptions. See Criddle, *supra* note 5 (proposing a republican theory of fiduciary law); Atkinson, *supra* note 12 (arguing that for-profit managers are public fiduciaries based on a neoclassical republican perspective).

<sup>148</sup> See *supra* note 146.

<sup>149</sup> See Markovits, *supra* note 75, at 217 (stating that the law builds "a measure of paternalism into every relationship").

<sup>150</sup> See McLeod and Ryman, *supra* note 38, at 73, 83 ("explaining how autonomy, understood rationally—that is, as *relational autonomy*—requires trust" and the determination of "whether a fiduciary's judgment is paternalistic or respectful of autonomy is whether it aligns with what the beneficiary wants for herself").

<sup>151</sup> E.g., *Nemec v. Shrader*, 991 A.2d 1120, (Del. 2010) ("[W]e must . . . not rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal. Parties have a right to enter into good and bad contracts, the law enforces both."); *Allen v. El Paso Pipeline GP Co., L.L.C.*, 113 A.3d 167, 184 (Del.Ch. 2014) (quoting *Nemec*: "A court must not use the implied covenant to 'rewrite [a] contract' that a party 'now believes to have been a bad deal.'").

law does not intervene merely for betrayal of trust or bad faith.<sup>152</sup> Absent a need for a legal rule, most dealings in the world are matters of assent, contract, and happenstance. The outcomes of these relations range from a pair of aces to a two-seven, and the law does not equalize the deal. A theory of fiduciary law requires an “elucidation of the social values” because the fiduciary principle, while existing in the context of a market economy and in furtherance of it, “its underlying premises are not those of individualistic private ordering.”<sup>153</sup> Absent a policy need, relationships are left to the realm of private ordering, which is the contractarian and libertarian preference.

I provide a counterargument that situates fiduciary law in political liberalism where freedom and autonomy is the first principle. Before undertaking that explanation, we must define liberalism. The philosopher Alan Ryan provides a helpful introduction for the purpose here. There is no single definition of liberalism, and it can assume a variety of institutional manifestations.<sup>154</sup> At the core of any version is a moral foundation of liberty and autonomy.<sup>155</sup> One variant of the philosophy is classical liberalism, which is in the Lockean tradition: “It focuses on the idea of limited government, the maintenance of the rule of law, the avoidance of arbitrary and discretionary power, the sanctity of private property and freely made contracts, and the responsibility of individuals for their own fates.”<sup>156</sup> Another variant is modern liberalism, which traces its tradition to Mill with John Rawls being the most eminent proponent: “it is exemplified by the assault on freedom of contract and on the sanctity of property rights represented . . . by Franklin Roosevelt’s New Deal between the wars, and

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<sup>152</sup> There are causes of actions that include betrayal of trust or bad faith, but not an independent tort based on such. *E.g.*, *Rawlings v. Apodaca*, 726 P.2d 565, 571 (Ariz. 1986) (in banc) (“The tort of bad faith developed as a response to insurance adjustment abuses in third-party liability cases.”); *Degan v. Ford Motor Co.*, 869 F.2d 889, 895 (5th Cir. 1989) (stating that oral inducements and deception between labor and management are “betrayal without remedy” given ERISA’s preference for written agreements); *Renko v. Northridge Care Ctr., Inc.*, 2005 WL 2045352, at \*19 (Cal.App. 2005) (ruling that “hopelessness and betrayal” alone are not a basis for a claim of intentional infliction of emotional distress).

<sup>153</sup> Weinrib, *supra* note 84, at 3.

<sup>154</sup> ALAN RYAN, *THE MAKING OF MODERN LIBERALISM* 21-23 (2012).

<sup>155</sup> *Id.* at 23, 25.

<sup>156</sup> *Id.* at 24. *See id.* at 23 (quoting John Locke’s claim that people are born “in a state of perfect freedom, to order their actions and dispose of their possessions, and persons, as they see fit . . . a state also of equality,” John Locke, *Two Treatises of Government* 287 (1690) (Peter Laslett, ed., 1967)).



by the explosion of welfare-state activity after World War II.”<sup>157</sup> Albeit in tension with classical liberalism, modern liberalism is also a form of liberalism because the underlying moral basis is couched in terms of liberty in negative form, the freedom from the privations in modern society.<sup>158</sup> The two traditions of liberalism differ on the role of government.<sup>159</sup> Classical liberalism sees a potential conflict at least with individual liberty.<sup>160</sup> Modern liberalism sees it as necessary to achieve broad social welfare.<sup>161</sup> At minimum, “the liberal view [is] that government power is to be treated with caution but, like any other instrument, may be used to achieve good ends.”<sup>162</sup>

With liberalism so defined, we see that fiduciary law has a legitimacy problem. In a liberal society, fiduciary law regulates private relationships by imposing a mandatory code of conduct. The contractarian approach to this conflict is to co-opt fiduciary law and declare it to be contract law.<sup>163</sup> Legal annexation is one way to solve the legitimacy problem. The move comports with classical liberalism with its emphasis on contract and marginalization of mandatory rules, thus minimization of government’s role in private affairs. But, as discussed, this move is problematic on several levels of doctrine, theory, and policy.<sup>164</sup> Another problem noted here is that

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<sup>157</sup> *Id.* at 25. *See id.* (quoting John Stuart Mill’s appeal to “man as progressive being” and should develop in all its “manifold diversity,” John Stuart Mill, *On Liberty* 120-22 (1861) (1974)).

<sup>158</sup> *Id.*

<sup>159</sup> Other commentators have articulated a similar difference between “classical liberalism” and “modern liberalism” with the former espousing the ideals of neoliberalism of the late twentieth century and the latter attributable to the liberalism of Roosevelt and the New Deal in the early to mid-twentieth century. *See* GARY GERSTLE, *THE RISE AND FALL OF THE NEOLIBERAL ORDER: AMERICA AND THE WORLD IN THE FREE MARKET ERA* 5-6, 25-26 (2022).

<sup>160</sup> “No classical liberal denies the need for law; coercive law represses force and fraud, and the noncoercive civil law allows people to make contracts and engage in any kind of economic activity.” RYAN, *supra* note 154, at 24. The line between classical liberalism and libertarianism “is not easy to draw” but one cleavage is that the latter views government as not a “necessary evil” but largely an “unnecessary evil.” *Id.* at 27.

<sup>161</sup> “Inasmuch as the ideals of the welfare state cannot be achieved without a good deal of government control of the economy, modern liberalism cannot treat property as sacrosanct and cannot limit government to the repression of force and fraud . . . .” *Id.* at 25.

<sup>162</sup> *Id.* at 27.

<sup>163</sup> *See supra* note 57 (Easterbrook and Fischel) and *infra* note 193 (Larry Ribstein).

<sup>164</sup> *See supra* Section I.C. and *infra* Section IV.B.

contractarianism must be relegated as a normative idea only. Fiduciary law as it exists is the inverse of the contractarian preference: it makes space for contracting but preserves mandatory rule as the core principle.<sup>165</sup> Fiduciary law is on the whole about right, which means that contractarianism is on the whole about wrong. The liberal theory advanced here not only contends with liberalism, but is founded on the core idea of liberalism. It rejects contractarianism as the proper concept fitted to political liberalism, but recognizes that contract serves an instrumental function.<sup>166</sup> This perspective comports with fiduciary law, and thus the liberal theory explains the law and the basis of its legitimacy.

Under the liberal theory, fiduciary relationships are based on an initial strong presumption that all relationships should be viewed as standing on equal footing, where persons deal arm's-length and have every opportunity for diligence in vetting. The negative proposition—*i.e.*, absence of equal footing due to its negation—advances the idea that we should be free to relate and should have agency. The negation of the initial strong presumption means that a person cannot stand on equal footing. *Cannot* is distinguished from *did not*; the former is a structural barrier to autonomy and agency, and the latter is a product of them or mere happenstance. This concept is consistent with liberalism. We are not concerned when in individual cases a person did not negotiate arm's-length or did not have equal footing. Freedom and agency mean that one is personally responsible for or must accept the outcomes of one's dealings, whether they be misfortune, malfeasance, or mishap.

The policy concern is structural barrier to autonomy and agency. That barrier is the nature of structural power. The power relation as defined here negates the initial strong presumption of freedom and agency.<sup>167</sup> The inability to monitor negates equal footing. Commentators have emphasized the problem of monitoring as a rationale of the fiduciary relationship.<sup>168</sup> The

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<sup>165</sup> This statement, for example, reflects modern business organization laws including the laws of partnership, limited liability company, and corporation. Delaware laws on limited partnership and limited liability company are the exception to mandatory fiduciary duties as the core of the fiduciary principle in business organizations.

<sup>166</sup> See *infra* Section IV.B.

<sup>167</sup> See *supra* Section II.C.

<sup>168</sup> See Scott & Scott, *supra* note 141, at 2427 ("The beneficiary in a fiduciary relationship is generally less well-positioned to monitor the agent's behavior than is the principal in a typical contractual agency relationship."); McLeod & Ryman, *supra* note 38,

lack of a means to monitor the fiduciary, such as market intermediaries, compounds this problem.<sup>169</sup> The implication is that systructural power and unequal footing negate freedom, autonomy, and agency. Consistent with both classical and modern versions of liberalism, government's intervention in this circumstance is needed and serves a necessary good.

When fiduciary law imposes a code of conduct, it does not intervene into private affairs so much as affirms freedom and agency. Of course, most fiduciary relationships are based on free choice, some on actual contract (*e.g.*, trustees, lawyers, partners, fiduciary institutions) and others on associational assent (*e.g.*, directors and officers). When fiduciary status is imposed on an *ad hoc* basis on unwitting persons, it is justified on the ground that the presumption of liberty, autonomy and agency have been undermined by the circumstance of the relationship. Autonomy and agency are the means to which a person achieves equal footing. When equal footing could not be achieved *vis-à-vis* was not achieved, the law creates, in the language of contractarians, the hypothetical (counterfactual) relationship grounded in equal footing. In this respect, the government's intervention into private affairs with a stringent code of conduct is consistent with liberalism and affirms the primary value of liberty, autonomy, and agency.<sup>170</sup>

## B. In Capitalism's Eye

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at 76 ("Beneficiaries are also rarely in a position to monitor the majority of the decisions that fiduciaries make while acting their fiduciary role."); Getzler, *supra* note 44, at 43 ("The court have tended to impose fiduciary duties where one party has a continuing authority or power over another, which is hard to monitor and control, and which exposes the entrusting party to a special vulnerability."); Brooks, *supra* note 77, at 235 ("A central part of what law does, particularly in the fiduciary context, is to attempt to overcome problems of verifiability through legal rules.").

<sup>169</sup> Often, the fiduciary is the market intermediary necessary to facilitate the transaction such as an accountant or lawyer. In other words, market actors typically do not hire an accountant to monitor another accountant or another lawyer. The adviser in question is the terminal relationship.

<sup>170</sup> Other commentators have argued that fiduciary law is consistent with autonomy and human agency. See Dagan & Hannes, *supra* note 78, at 105 ("the role of private law [which] is to enhance people's autonomy by facilitating forms of interpersonal interactions that are conducive to human flourishing").

A brief comment is made on the role of fiduciary law in our economic organization. Weinrib observes that courts are reluctant to mediate “the morality of business transactions” through the fiduciary principle.<sup>171</sup> He is right to situate the fiduciary principle in a capitalist society. Cardozo too invokes a relationship between a market system and the fiduciary principle.<sup>172</sup> This part of the fiduciary principle requires little justification of its legitimacy.

A fiduciary principle is an important doctrine in a capitalist system and a market economy.<sup>173</sup> A major part of a “critical interest” is money and wealth.<sup>174</sup> It is likely that most wealth, held in fiduciary institutions or corporate stocks, is protected by the fiduciary principle. Directors, officers, partners, investment advisers, and fiduciary institutions are a part of the capitalist and market systems. Much of the capital markets and household wealth are managed by institutions subject to fiduciary law.<sup>175</sup> As discussed above, managers of corporations are subject to mandatory fiduciary principles.<sup>176</sup> Most monies and wealth in the market are clothed in the fiduciary prophylactic.

A fiduciary relationship is a special relationship, which connotes an uncommonness relative to all human relationships. Yet it is common and pervasive in our society because power in relation to critical interests are common. This simply speaks to the amount of wealth held in our society. Fiduciary relationships, albeit special in terms of the uncommonness of

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<sup>171</sup> Weinrib, *supra* note 84, at 2 (“Given the acceptance by the courts of the value inherent in a capitalist society order, at least in a rudimentary sense, and the fear that it may be beyond a judge’s competence to supervise the morality of business transactions, judicial diffidence is understandable.”).

<sup>172</sup> “A trustee is held to something stricter than the morals of the market place.” *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C.J.).

<sup>173</sup> See generally JAMES P. HAWLEY & ANDREW T. WILLIAMS, *THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC* (2000).

<sup>174</sup> It goes without saying that other critical interests are equally important. *Supra* Section II.E. The discussion here involves capitalism, which principally focuses the critical interest on money and wealth.

<sup>175</sup> See HAWLEY & WILLIAMS, *supra* note 173, at xii (noting the trend of “fiduciary capitalism” in which large fiduciary institutions have become the dominant stockholders in the capital markets); Dagan & Hannes, *supra* note 78, at 91 (noting that as much as \$14 trillion are managed by trustees of the US pension system, as of 2012).

<sup>176</sup> See *supra* note 64-65 and accompanying text.

their attributes, are commonly seen because the capitalist system in our society is entrusted with tremendous wealth.

#### IV. INSTRUMENTAL ATTRIBUTES OF THE LIBERAL THEORY

##### A. Positive Explanatory Power

The liberal theory is a general statement of the fiduciary principle. It restates existing law, except that the theory uses different lexicon. I contend that fiduciary law is about right, which is a normative statement.<sup>177</sup> This statement also means that the liberal theory does not suggest fundamental revision of this field, which is immense and cross many fields of law. The theory explains the status quo.

A major contribution of this article is the elimination of notion of trust, confidence, and vulnerability. Their overinclusive and undistinguishing nature suggest that they are not real causal factors. Courts and commentators invoke them simply because they are correlative facts and thus commonly seen in fiduciary relationships. But they are theoretically irrelevant. Whether the liberal theory is a good positive theory can be assessed on how well it replicates the outcomes seen in existing law. In truth, most theories predict clear, uncontested fiduciary relationships with little trouble. Little attention is needed to confirm whether trustees, directors, officers, or guardians are fiduciaries. The search for a theory, positive or normative, is a search for a test to distinguish fiduciary relationships from private affairs. In this respect, a prediction of non-fiduciary relationships provides better insight. On this score, the liberal theory performs well.

The liberal theory states that most commercial relationships are non-fiduciary because, while they involve a critical interest (money and wealth), parties have the capacity to deal arm's-length and do not hold systructural power. The theory rejects friends and other personal relationships for the same reason: they stand shoulder's-length and lack systructural power. With respect to power, when people stand in equal footing, we cannot say that there is structural power because there is no fixed orientation of the power. Ex ante, we do not know the orientation of power among business

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<sup>177</sup> Of course, at the granular level, one may disagree with any number of rulings and rules, but this article is not that inquiry.

associates and friends. The initial strong presumption is that they generally stand in equal footing and have every opportunity to be diligent in vetting their relationships.

Perhaps the hardest cases in fiduciary law involve advisers. Some are fiduciaries and some are not,<sup>178</sup> and they lack discretionary authority that is the core of the dominant theory of fiduciary relationships. The liberal theory works well to distinguish advisers. Assuming a critical interest, the theory states that only advisers with systructural power are fiduciaries. This condition would eliminate the large majority of advisory relationship even when there is a hierarchy, trust, confidence, and vulnerability. Most advisory relationships that courts have recognized involve advisers in specialized fields or specialized knowledge. Disparity in knowledge in such circumstances are systemic to specific categories of relationships or types of transactions. A need for such advice or felt compunction to adhere also creates a structural power relation between the fiduciary and the beneficiary even when the latter has free agency to reject the advice because the situation militates a compunction to follow the advice.

Consider the facts in *Burdett v. Miller*, a case that was correctly decided. The liberal theory predicts the outcome. The critical fact there was not that Burdett and Miller were friends. Miller had superior knowledge as a result of the fact that he was her accountant, her teacher, and a university professor with credentials relevant to investment. Relationships of this kind are systemic because they constitute a well-defined category of adviser–advisee relationships. While each case may be unique, numerosity can be reasonably inferred from the basic facts. The disparity in knowledge, expertise, and information asymmetry creates structural power. Miller’s persistence in actively soliciting an investment from Burdett under these conditions negates the presumption of equal footing. In cases with these kinds of facts, the polarity of power tends to be fixed in one direction. Lastly, the critical interest here was money and wealth. The liberal theory works well to predict the outcome.

## B. The Liberal Theory and Contractualism in Firms

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<sup>178</sup> See generally Laby, *supra* note 5 (discussing advisers as fiduciaries).

Under the liberal theory, the instrumental function of the fiduciary principle is to equalize a relationship that cannot be equalized.<sup>179</sup> It provides the rules of internal affairs of a private relationship when equal footing, which allows arm's-length dealing and diligence in vetting, cannot exist due to systructural power. This instrumental function creates doctrinal space for contractualism.<sup>180</sup> The notion of equal footing is not binary. The power relation, thus the capacity for equal footing, lies on a spectrum. Accordingly, the fiduciary principle permits a role for contracting.<sup>181</sup> The sliding scale controls the degree of contracting that should be permitted. An idea from classical liberalism, at least, is that government intervention should apply only to the extent that it is needed to achieve some good.<sup>182</sup> The corollary is that when it is unnecessary, private ordering of the relationship should be permitted. The possibility of contractualism with a mandatory core principle is consistent with existing law.

The laws of business organizations reveal how the sliding scale works. The law presumes that partnerships and limited liability companies are generally closely held firms. A partner in a general partnership has equal managerial power and agent status to manage the business and affairs of the partnership.<sup>183</sup> It is presumed that they collectively manage the firm. With respect to each other, then, they stand on equal footing and have the

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<sup>179</sup> Commentators differ on the instrumental function of fiduciary law. Scholars partial to economic analysis, such as Cooter, Freeman and Sitkoff, argue that fiduciary law functions to deter wrongful conduct. *Supra* notes 79-80 and accompanying text. Criddle argues that the function of fiduciary law is to protect against domination. *Supra* notes 93-96 and accompanying text.

<sup>180</sup> See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625 (1995).

<sup>181</sup> See generally Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 524-31 (2017) (documenting how LLCs contract around fiduciary duties); Peter Molk, *Uncorporate Insider Trading*, 104 MINN. L. REV. 1693 (2020) (examining the effects on insider trading law from Delaware's contractarian approach).

<sup>182</sup> See *supra* notes 160-162 and accompanying text.

<sup>183</sup> REVISED UNIF. P'SHIP ACT § 301(1) (Unif. Law Comm'n 1997 and harmonized 2013) ("Each partner is an agent of the partnership for the purpose of its business."); *id.* § 401(f) ("Each partner has equal rights in the management and conduct of the partnership business.").

capacity to monitor.<sup>184</sup> The same observations hold for limited liability companies that are managed by its members.<sup>185</sup> Given where owners stand with respect to each other on the slide scale of power relation and capacity for equal footing, the laws of partnerships and limited liability companies permit substantial contracting for fiduciary duties. Partnership law provides that the partnership agreement may not eliminate the duty of loyalty, but may “may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable . . . [and partners] may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.”<sup>186</sup> The rules for limited partnerships and limited liability companies are substantially the same.<sup>187</sup>

If partners have power parity with each other and have the capacity to monitor each other, what justifies a core mandatory fiduciary duty? Why is the relationship not entirely contractual? In Delaware, it is purely contractual with respect to limited partnerships and limited liability companies because they are seen as almost purely contract-based firms.<sup>188</sup> However, in a majority of states as represented by the uniform laws, the

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<sup>184</sup> Based on these legal facts, Larry Ribstein argues that “neither partners nor owners of partnership-type firms have fiduciary duties solely in their capacity as such.” Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 251 (2005). He reasons that “a fiduciary duty is appropriate only where the owner delegates open-ended power to the manager,” and in partnerships this condition is not met because partners have equal management powers and agency authority. *Id.* 217, 238-39. Partners should have default fiduciary duties only when they act “as agents or as managers of centrally managed firms.” *Id.* at 251.

<sup>185</sup> The management structure of limited liability companies can take any form. However, there are generally two basic types of management structure. See REVISED UNIF. LTD. LIAB. CO. ACT § 407(a) (Unif. Law Comm’n 2006 and harmonized 2013). A member-managed company is managed collectively by its owners, which is the general partnership model. *Id.* § 407(b). A manager-managed company is managed by a manager, which is the model of a corporation. *Id.* § 407(c). In a limited partnership, the limited partner is a passive investor. See UNIF. LTD. P’SHP ACT § 302 (Unif. Law Comm’n 2001 and harmonized 2013), § 402(a), § 406(a).

<sup>186</sup> REVISED UNIF. P’SHP ACT § 103(b)(3) (Unif. Law Comm’n 1997 and harmonized 2013).

<sup>187</sup> See UNIF. LTD. P’SHP ACT § 110(b)(5) (Unif. Law Comm’n 2001 and harmonized 2013) (same). The law of limited liability company similarly permits contracting for the duty of loyalty “if not manifestly unreasonable.” REVISED UNIF. LTD. LIAB. CO. ACT § 110(d) (Unif. Law Comm’n 2006 and harmonized 2013).

<sup>188</sup> See *supra* notes 62-63 and accompanying text.



core fiduciary duty is mandatory, and this approach is theoretically sound, and much sounder than Delaware's approach.<sup>189</sup> The argument for pure contractualism assumes that a partnership is an aggregate of its partners, not surprising as this is consistent with the reductionist approach toward contractualism where the only reality are the interactions of oxygen breathers.<sup>190</sup> The marginalization of the firm as a distinct entity is an orthodoxy and preoccupation of contractarianism.<sup>191</sup> Some have gone so far as to say that the firm *qua* entity does not exist.<sup>192</sup> When a partnership is seen as an aggregate of partners, the fiduciary relationship is configured as

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<sup>189</sup> The possibility of eliminating all fiduciary duties under Delaware law (and a few other states) is a marketing device by Delaware to distinguish itself from the rest of the pack. It is way of saying that Delaware takes the "policy of freedom of contract" more seriously than any other state. But from a policy perspective, the law makes little sense. It creates more victims of opportunism than is necessary for the purpose of contracting ex ante for expected issues with default fiduciary duties given the ex ante set of circumstance among owners and managers. Delaware's answer to this problem is *caveat emptor*. See *In re Encore Energy P'rs Unitholder Litig.*, 2012 WL 3792997 at \*13 (Del. Ch. 2013) ("[T]he 'right to enter into good and bad contracts' makes the implied covenant an ersatz substitute for the warning 'caveat emptor.' Investors apprehensive about the risks inherent in waiving the fiduciary duties of those with whom they entrust their investments may be well advised to avoid master limited partnerships."). One cannot image a plausible situation in which rational passive investors would ever agree to complete elimination of fiduciary duties such that managers can lawfully rob them blind, *i.e.*, egregious self-dealing. The fact that some investors do is not evidence of rationality, but proof of the old adage that the world is full of irrational people. The existence of irrational people does not mean that the law should readily give a thief the keys to the bank. If investors are not passive, a complete elimination of fiduciary duties would mean that they should and would be looking over their shoulders constantly so that they are not robbed blind. The monitoring costs would be fairly high. The elimination of fiduciary duties serves only one purpose—to eliminate liability for even the most blatant abuse. Such a rule is good for Delaware's business that caters to business managers, but there is little doubt that it is bad policy.

<sup>190</sup> See *supra* notes 67, 77.

<sup>191</sup> E.g., *supra* note 67 (discussing the reductionism of the contractarian view of some); Stephen M. Bainbridge, *Contractarianism in the Business Associations Classroom: Kovacik v. Reed and the Allocation of Capital Losses in Service Partnerships*, 34 GA. L. REV. 631, 643 (2000) ("In brief, contractarians regard the firm not as an entity, but simply as a legal fiction representing the complex set of contractual relationships between these inputs.").

<sup>192</sup> See *id.* at 643; EASTERBROOK & FISCHER, *supra* note 57, at 12 ("The 'personhood' of a corporation is a matter of convenience rather than reality"). See also William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 265 (1992) ("in its most radical form, the corporation tends to disappear, transformed from a substantial institution into just a relatively stable corner of the market in which autonomous property owners freely contract").

partner-to-partner. The equal footing of partners under partnership law suggests not only the possibility of pure contractualism, but also the implication that an element of the liberal theory (and most other theories of the fiduciary relationship) is not satisfied.<sup>193</sup> Accordingly, mandatory fiduciary duty disappears, and rightly so since the fiduciary principle has no role in relationships presumed to be on equal footing.<sup>194</sup>

However, ardent contractualism's deliberate disregard of the firm flies in the face of actual law and reality. Under modern partnership law, the partnership is a separate and distinct entity.<sup>195</sup> The idea that a firm is separate and distinct from its owners and managers is blackletter law and unavoidable legal fact.<sup>196</sup> When the partnership is seen as a separate, distinct entity, the configuration of fiduciary duty is also partner-to-partnership. Fiduciary duties are owed to "the partnership and the other partners."<sup>197</sup> Likewise, this configuration is also seen in corporation law, which required duties owed to "the corporation and its stockholders."<sup>198</sup> The entity does not stand in equal footing because it is a legal person that does not stand in a power parity with a partner. The firm is helpless as to a partner's bad conduct. To be clear, this statement is not anthropomorphism or reification, as contractarians like to admonish whenever a non-oxygen breather is recognized to be a person or a firm is attributed with an action

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<sup>193</sup> This is Ribstein's point. He argues that partners stand in equal footing, and thus the imposition of fiduciary duty per status as a partner is unnecessary. *See supra* note 184.

<sup>194</sup> *See supra* note 18 and accompanying text.

<sup>195</sup> *See* REVISED UNIF. P'SHIP ACT § 201(a) (Unif. Law Comm'n 1997 and harmonized 2013) ("A partnership is an entity distinct from its partners."). *See also* REVISED UNIF. LTD. LIAB. CO. ACT § 201(a) (Unif. Law Comm'n 2006 and harmonized 2013) (same for limited liability companies); UNIF. LTD. P'SHIP ACT § 104(a) (Unif. Law Comm'n 2001 and harmonized 2013) (same for limited partnerships).

<sup>196</sup> *See Corporation as Legal Entity*, 18 CORPUS JURIS SECUNDUM § 6 (updated Sept. 2019) ("The basic purpose of incorporation is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs."). Entity distinctness and personhood serve vital instrument function of limited liability and asset partitioning. *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000).

<sup>197</sup> REVISED UNIF. P'SHIP ACT § 404(a) (Unif. Law Comm'n 1997 and harmonized 2013); REVISED UNIF. LTD. LIAB. CO. ACT § 408(a) (Unif. Law Comm'n 2006 and harmonized 2013); UNIF. LTD. P'SHIP ACT § 409(a) (Unif. Law Comm'n 2001 and harmonized 2013).

<sup>198</sup> *Arnold v. Society for Sav. Bancorp, Inc.*, 678 A.2d 533, 539 (Del. 1996).

verb.<sup>199</sup> One readily concedes that a firm is not a human being and exists by virtue of an electronic filing in the state. With this concession out of the way, the firm's powerlessness means that by virtue of equal management power and agency, each partner can exercise power over the entire partnership, *qua* entity, in a way that is qualitatively distinct from the exercise of power in partner-to-partner relationships. This difference has real consequences on expected misbehavior and costs therefrom.

In a person-to-person relationship where each person stands on equal footing with respect to each other, there is no reason to impose a fiduciary status.<sup>200</sup> Parties are always free to enter into a contractual agreement based on some convenience, a matter of freedom to contract. But a firm is a separate and distinct person such that when assets and capital are contributed, the firm legally dispossesses the partner of these things upon contribution and is now the owner.<sup>201</sup> The firm's ownership of property and things are real, and this legal separation of property is vital to the *raisons d'être* of firms.<sup>202</sup> By virtue of equal power and control, each partner can exert power over the entire firm, *i.e.*, all partnership property and interests.<sup>203</sup> One can argue that partners can monitor each other against such abuse, but the argument cannot deny the power of each partner over the partnership. In other words, there is always a real, serious risk of any partner misbehaving, and this risk increases and becomes more complex

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<sup>199</sup> See Stephen M. Bainbridge, *Competing Concepts of the Corporation (A.K.A. Criteria? Just Say No)*, 2 BERKLEY BUS. L.J. 77, 85 (2005) (quoting WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 117-18 (9th ed. 2004)) ("The fictional (conceptual) entity becomes a putative person—capable, for example, of committing a crime or appealing the burden of a tax. In other words, reification sometimes leads to anthropomorphism.").

<sup>200</sup> See *supra* notes 184 and 193 (discussing Ribstein's idea that partners should not be fiduciaries by virtue of status).

<sup>201</sup> Each owner "hold[s] as trustee for [the entity] any property, profit, or benefit" belonging to the firm. REVISED UNIF. P'SHIP ACT § 404(b)(1) (Unif. Law Comm'n 1997 and harmonized 2013); REVISED UNIF. LTD. LIAB. CO. ACT § 409(b)(1) (Unif. Law Comm'n 2006 and harmonized 2013); UNIF. LTD. P'SHIP ACT § 408(b)(1) (Unif. Law Comm'n 2001 and harmonized 2013).

<sup>202</sup> A function of business organization law is asset partitioning. See generally Hansmann & Kraakman, *supra* note 196.

<sup>203</sup> See REVISED UNIF. P'SHIP ACT § 301(1) ("An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership").

with each additional partner.<sup>204</sup> Each partner can blow up the firm, not just the particular interest at stake in each person-to-person relation. At some point not too far from the simple two-partner firm, partners cannot continuously monitor all other partners who have equal power to abuse the firm at the individual partner-to-partner level.

Under this analysis, the partnership is a real tangible thing. The firm is the legal owner of property and also undertakes its own debts and liabilities, which is a critical fact unpinning the foundational rule of limited liability (which cannot be ginned up by contract<sup>205</sup>). The idea that fiduciary duty also exists at the partner-to-partnership level is the correct theory. It is not redundant with duties existing at the partner-to-partner level. The fiduciary principle has a key function, and this means that the entity is a real thing, which is exactly what the law actually is. Arguing against the firm's existence on the basis of reification is a rhetorical device. The partnership as a distinct and separate person exists in a power disparity with respect to each partner in a way that is qualitatively different in a partner-to-partner relationship, precisely because the entity cannot literally punch back. Control, which is structural power in all firms, is the crucial element here, and control in and over a powerless firm justifies the imposition of mandatory duties to the firm. When the noncorporate entity is a distinct entity and partners exercise control in and over the entity, the fiduciary analysis is analytically analogous to that of corporate officers and

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<sup>204</sup> The intuition here is that in a simple two-partner firm, each partner can expend a small amount of resource to monitor each other. When a partner is added, each partner now expends twice as much resources to monitor. The cost at the personal level increases with each additional partner. At some point, the aggregate of costs may be prohibitive. Easterbrook and Fischel recognize this problem. See Easterbrook & Fischel, *supra* note 57, at 438 ("When transactions costs reach a particularly high level, some persons start calling contractual relations 'fiduciary'").

<sup>205</sup> See Robert J. Rhee, *Bonding Limited Liability*, 51 WM. & MARY L. REV. 1417, 1426, 1444 (2010) ("Tort law is a wrench in the smooth machinery of the contractarian explanation. . . . Where the existence of tort law is the baseline, private ordering cannot synthetically gin up the legal right of limited liability.").

directors.<sup>206</sup> This explains why the core of fiduciary duty in a partnership is mandatory and should not be purely contractual.<sup>207</sup>

With respect to corporation law, shareholders in a corporation are presumed to have little power and have limited means to monitor managers therein. It has long been recognized that the corporation is characterized by the separation of ownership and control.<sup>208</sup> Management of the corporation is vested in the board of directors.<sup>209</sup> Shareholder participation is generally limited to voting on required matters,<sup>210</sup> and even with voting power shareholders are thought to be rationally apathetic.<sup>211</sup> The negation of equal footing and the inability to monitor through the structure of the corporation are attributed to the mandatory rules in corporation law.<sup>212</sup> Mandatory

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<sup>206</sup> Control over and in the entity determines whether a person owes fiduciary duty in the firm. *See* *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987) (“Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation.”); UNIF. LTD. P’SHIP ACT § 305(a) (“A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner.”); *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009) (“officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty”); REVISED UNIF. P’SHIP ACT § 404(a) (“The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care”).

<sup>207</sup> *But see* DEL. CODE ANN., tit. 6, § 18-1101(c) (“duties may be expanded or restricted or *eliminated* by provisions in the limited liability company agreement”) (emphasis added); *id.* § 17-1101(d) (same as to limited partnerships). The same analysis would apply to limited partnerships and limited liability companies because these entities are not materially different from general partnerships with respect to the issue of contractual elimination of fiduciary duties. Accordingly, the Delaware approach is misguided to the extent it permits complete elimination of fiduciary duties. *See supra* note 189.

<sup>208</sup> ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

<sup>209</sup> DEL. CODE ANN., tit. 8, § 141(a).

<sup>210</sup> *E.g., Id.* § 251(c) (requiring shareholder vote on merger).

<sup>211</sup> *E.g., Jana Master Fund, Ltd. V. CNET Networks, Inc.*, 954 A.2d 335, 340 (Del.Ch. 2008) (“Shareholders, however, are generally passive and may exercise their rights usually once a year by voting at the corporation’s annual meeting. Yet, even with only this single task, most shareholders are rationally apathetic, the prevailing wisdom explains.”).

<sup>212</sup> “Notably the explanation most often pressed forward for the efficiency of mandatory terms in corporate law is that the consent to modified terms of a corporate contract through a corporate election may (in the case of public corporations particularly) not really constitute the sort of agreement that we *ought* to enforce because of the existence

rules of corporation law include mandatory, unalterable fiduciary duty.<sup>213</sup> Consistent with the view that the entity is real and fiduciary duties run from manager to the firm, corporate fiduciary duty is generally stated as being owed to “the corporation and shareholders.”<sup>214</sup> Here again, the theoretical foundation of mandatory fiduciary duty is power disparity in the manager-to-firm relationship. When the firm, *qua* distinct entity and person, is incapable of achieving equal footing, the relationship meets the criteria of the liberal theory of fiduciary law. It requires governmental imposition of mandatory rules.

Lastly, the possibility of contractualism in fiduciary law with a core mandatory component is consistent with existing law in another way. The establishment of a presumptive breach of a fiduciary duty does and should not result in liability *per se* if the beneficiary has been benefitted, or at least not harmed.<sup>215</sup> The laws of business organizations permit the defense of fairness.<sup>216</sup> Fairness is the core of equity jurisprudence. The sliding scale applies here. The contractarian argument is that courts are merely filling in “contractual” terms that the parties would have agreed upon in a

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of asymmetrical information and rational apathy on the part of widely disaggregated shareholders of public companies.” *Matter of Appraisal of Ford Holdings, Inc. Preferred Stock*, 698 A.2d 973, 977 n.8 (Del.Ch. 1997) (emphasis in original) (citing Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989)).

<sup>213</sup> See *supra* note 65.

<sup>214</sup> E.g., *Arnold v. Society for Sav. Bancorp, Inc.*, 678 A.2d 533, 539 (Del. 1996) (“Fiduciary duties are owed by the directors and officers to the corporation and its stockholders.”).

<sup>215</sup> This idea is seen in commentary on fiduciary law. Langbein argues in the context of trusts that “a transaction prudently undertaken to advance the best interest of the beneficiaries best serves the purpose of the duty of loyalty, even if the trustee also does or might derive some benefit. A transaction in which there has been conflict or overlap of interest should be sustained if the trustee can prove that the transaction was prudently undertaken in the best interest of the beneficiaries.” John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 932 (2005).

<sup>216</sup> See REVISED UNIF. P’SHP ACT § 409(g) (Unif. Law Comm’n 1997 and harmonized 2013) (“It is a defense to a claim . . . in equity or at common law that the transaction was fair to the partnership.”); REVISED UNIF. LTD. LIAB. CO. ACT § 409(g) (Unif. Law Comm’n 2006 and harmonized 2013) (same); UNIF. LTD. P’SHP ACT § 409(g) (Unif. Law Comm’n 2001 and harmonized 2013) (same); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (“Under the entire fairness standard of judicial review, the defendant directors must establish to the court’s satisfaction that the transaction was the product of both fair dealing *and* fair price.”).

hypothetical bargain had transaction costs been zero. By the very terms of this argument, it is an imaginary thing in the mind of the ruminator.<sup>217</sup> The simpler explanation is that the firm as an independent entity is helpless against the opportunism of owners and managers, but if there is no harm to the firm there is no foul. The firm has not been injured because there was no breach of a duty imposed by law.

### C. Elasticity and Pliability of Standard

Because fiduciary law is grounded in equity, the principle has been said to be indeterminate due to judicial method in equity.<sup>218</sup> Commentators have expressed a concern about its elasticity: “as with equity, courts and commentators often state that fiduciary law is not closed, but nervousness about its open-endedness probably explains why courts try to hew to the established categories based on known status relationships.”<sup>219</sup> Fiduciary law is mainly in the realm of statutes and contracts. New statutes are always on the horizon, and courts always confront new cases and legal application. A theory of the fiduciary principle should consider its elasticity and pliability in application.

The liberal theory is sufficiently elastic and pliable. It is elastic enough because it permits expansion of the fiduciary principle to new categories of relationships. It is pliable because its elements—systructural power, negation of equal footing, and critical interest—are sufficiently flexible to apply to any relationship under scrutiny. As such, the liberal theory rejects taxonomical originalism, *i.e.*, an ossification of fiduciary relationships to historically recognized categories of relationships.<sup>220</sup> The germ of the liberal theory’s construction is the incongruous data of ad hoc fact-based fiduciary

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<sup>217</sup> See Easterbrook & Fischel, *supra* note 57, at 445 (“Creating hypothetical contracts is difficult. Judges have less information than parties.”).

<sup>218</sup> The concept of a fiduciary relationship originates in equity, thus its vicissitudes subject to the chancellor’s judgment of equity. See *supra* notes 1, 2, 22, 50.

<sup>219</sup> Smith, *supra* note 22, at 278. See *supra* notes 2 and 22 and accompanying text.

<sup>220</sup> A theory of the fiduciary relationship based on discretionary authority more closely hews to originalism because the principle is grounded in prototypical fiduciary relationships, the paradigm one being the trustee and beneficiary. Discretionary authority is begotten from contract or statute, which sharply limits the possibility of a judicial rule of a fiduciary relationship or a theorization of a fiduciary relationship outside of contract or statute. It is the most limiting principle.

relationships,<sup>221</sup> which consistently present new circumstances in which the fiduciary principle applies. The liberal theory is workable as a concrete concept to analyze future cases testing the boundaries of fiduciary law.

However, the opposite concern is too much elasticity. In equity, which has a moral core, the temptation to remedy perceived betrayal of trust, exploitation of vulnerability, and violation of social norms is always there. The hoary adage “hard cases make bad law” is apt. The situations that can involve a harm to a critical interest are practically unlimited. When bad things happen to important things, the relationship could be called into question. What are the constraints on the imposition of a fiduciary obligation? Or should the presumption be against constraint and for greater liberalization of the principle?

The concept of a fiduciary relationship could be subject to ever greater expansion. The instinct is to expand the concept. Commentators have continued to push the boundary and have argued that friends, voters, creditors, depository banks, bankers, brokers, employees, and politicians are fiduciaries.<sup>222</sup> Each argument for expansion requires an individualized analysis. The general observation, however, is that the fiduciary principle could become ever-expanding ripples of fiduciary obligations in society at large. Unless the fiduciary relationship is properly theorized in the context of a liberal society, each correction of opportunism, abuse of trust, and exploitation could become an incremental loss of autonomy and law’s advance into private affairs.

A theory should be sufficiently inelastic to constrain the fiduciary principle. The fiduciary relationship, as properly theorized, advances autonomy and agency and thus is consistent with liberalism.<sup>223</sup> But as a mandatory rule with a moral core, its imposition always presents the risk of a reduction in autonomy and agency. Whenever a judge is required to mediate ex post a relationship on an ad hoc basis, the ex ante autonomy to interact with others without the intervention of law could be seen as having been diminished. We should acknowledge the tradeoff. Most bad outcomes involving a relationship, even when critical interests such as money and wealth are involved, are not intermediated through law.

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<sup>221</sup> See *supra* Section II.A.

<sup>222</sup> See *supra* note 4.

<sup>223</sup> See *supra* Section III.A.



In this respect, courts have gotten the task of line-drawing about right. While one always quibbles with the outcome of cases here and there, courts have achieved the right outcomes in the main. They have rejected the recognition of a fiduciary relationship in a wide range of relationships, *e.g.*, customers, franchisees, counterparties, debtors, brokers, friends, and advisers.<sup>224</sup> A commonality runs through many of these cases – they are based on the initial strong presumption of equal footing with no indication of systructural power negating that presumption. Reflecting the state of the law as it exists, the liberal theory is sufficiently inelastic. Its elements are sufficiently stringent to cabin the fiduciary principle so that random allegations of inequity, abuse of power, and unfairness do not suffice.

With its stringent conditions, the liberal theory sufficiently constrains unchecked expansion of the fiduciary principle. At the same time, it is sufficiently pliable to new situations and problems. If a relationship is based on systructural power over a critical interest and that power negates equal footing, a fiduciary relationship should attach. This principle is sufficiently pliable to address a wide variety of future contexts.

## CONCLUSION

The liberal theory sets forth the core elements of a fiduciary relationship. A fiduciary relationship arises only when: power exists in a relationship; power exists in a systructural state; systructural power negates the strong presumption of equal footing; and systructural power is exerted against a critical interest. This theory is a positive theory. The boundaries set by this theory generally explain fiduciary relationships recognized in law and relationships determined to be non-fiduciary. The theory fits all relationships created by law or contract and whose status as a fiduciary relationship. It also explains ad hoc fact-based relationships.

The liberal theory is a normative theory. It reflects how fiduciary law should work. It is grounded on a political and economic foundation. We live in a society that places high value on liberty, property, and autonomy. Although we may disagree on the role of government depending on where one lies on the political and philosophical spectrum, most would agree that liberty, property, and autonomy are important. In a liberal society and a

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<sup>224</sup> See *supra* note 18. Of course, given the right set of facts, these relationships can result in ad hoc fact-based fiduciary relationships.

market system, we should respect autonomy and human agency in dealings. In policy translation, this means the strong presumption of the law's noninterference with private affairs. This policy is the animating force of libertarians and contractarians who seek to diminish fiduciary law. Yet the liberal theory recognizes the practical reality of systructural power and its exertion against critical interests. All societies elevate certain values. Some interests are so important that the law does and should intervene in otherwise private affairs to protect them. These critical interests in a liberal, capitalist society are money and wealth, liberty interests of body and wellbeing, and other rights-based interests. Fiduciary law protects these critical interests only when we cannot presume the capacity for equal footing because autonomy and agency have been negated.

The liberal theory is sufficiently inelastic because the conditions of its elements are stringent. A fiduciary relationship imposes stringent duties and remedies. It should not be imposed casually. The presumption of equal footing means that we presume non-paternalism and non-interference in most relationships. A theory of fiduciary law should not be a tool to remedy generalized, unmoored assertions of unfairness, bad outcomes, or social problems. Yet a theory, like the common law, must be sufficiently pliable for posterity. The common law is not entombed in ossified originalism, and progress is not a dirty word. From the origin of the trustee-beneficiary relationship in the eighteenth century, the law has recognized many new categories of fiduciaries. The law progressed and developed. The liberal theory is sufficiently flexible to consider new circumstances whenever systructural power is imposed against a critical interest.