The Fiduciary Gap

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I. INTRODUCTION

In our daily interactions with others, we hope that the other party will not take advantage of us or cheat us. In some settings, we may go so far as to hope that the other party will act with our best interests at heart, that she will do for us as we would have done for ourselves or for someone we love. In a world of free contracting, we should be able to pay someone enough to agree to put our interests above all others in the performance of some task on our behalf. We should at least be able to induce them to agree to eschew self-interest in performing what is promised.

Indeed, we can make such fiduciary agreements, though the law will not enforce them to the full extent of their aspirational terms. The law will not enforce one party's agreement to be devoted to another's interests or to care for another to the same degree one would for a best friend, family member, or for one's self. Instead, fiduciary contracts are enforced to the extent practical to ensure that the fiduciary does not indulge conflicted interests. The gap between the aspirational views many of the parties hold of fiduciary relationships and the realities of enforcement adds a layer of uncertainty and incompleteness to fiduciary contracts that neither the law nor scholarship have considered. This Article reveals this unappreciated gap in fiduciary agreements, and, in doing so, discovers an unenforceable contract term that both parties may want to agree to, but neither would actually want the law to enforce.

All contracts are, to some degree, incomplete.[1] An agreement between two parties can neither comprehensively define all of the ways the parties are to behave in performing their obligations under the contract, nor provide for every possible circumstance the parties will encounter during their interaction. This kind of contractual incompleteness has been thoroughly studied and theories about how to fill gaps in incomplete contracts are well-developed.[2] Fiduciary contracts are considered the most incomplete contracts in that regard.[3] They provide the least specificity about how the fiduciary is to perform her contracted obligations because the vulnerable party, the beneficiary, usually lacks the expertise to specify terms and further lacks the time, expertise, or both, necessary to carefully monitor the fiduciary. Beneficiaries defer to the fiduciary's discretion in the performance of the task.[4]

Courts rely on "gap fillers" to determine unspecified obligations in contractual relationships.[5] Gap fillers are standards that guide courts in figuring out what outcome is

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1. *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87–91 (1989) (proposing that contract law contains more default rather than immutable rules); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 426 (1993) (noting that the duty of loyalty is a response to the contract's incompleteness).

2. The literature is vast, but examples of notable work include: Ayres & Gertner, *supra* note 1; Easterbrook & Fischel, *supra* note 1; Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261 (1985) (arguing that the standard contractual terms creates barriers to innovative contractual agreements), with symposium issues devoted to the topic appearing in 56 CASE W. RES. L. REV. (2005) and 33 FLA. ST. U. L. REV. (2006).

3. Easterbrook & Fischel, *supra* note 1, at 426.

4. *Id.*

5. *Id.* at 429; *see* Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 224 (2005) (noting the differences between gap fillers and open ended fiduciary relationships); Ayres & Gertner, *supra* note 1, at 87 (noting that courts use gap fillers to resolve contractual ambiguities); D. Gordon Smith, *The Critical*

appropriate given the conditions of contracting and the parties' expectations.[6] One common method of gap filling is considering a "hypothetical bargain" between the parties, that is, determining what the parties would have agreed had they negotiated about the unanticipated circumstance at the outset.[7] Some scholars argue that fiduciary duties are gap fillers in some kinds of incomplete contracts.[8] Courts considering an unanticipated event in a fiduciary relationship begin with the premise that the fiduciary agreed not to self-deal in the performance of its obligations. That duty of loyalty to the other party guides courts in deciding what the parties would have agreed about how the fiduciary should behave in unanticipated circumstances.

While the gap-filling view of fiduciary duties is helpful, it is not universally accepted. The two dominant perspectives in the debate about the nature of fiduciary relationships and duties disagree about whether fiduciary relationships are contracts at all and how courts should respond to problems within the relationship. Contractarians[9] argue that fiduciary relationships are contracts and fiduciary duties are the chosen gap fillers courts use to respond to unanticipated problems.[10] Anti-contractarians, on the one hand, argue that contract law does not explain the nature of many fiduciary relationships, which they believe are based on trust, not the result of bargaining.[11] Anti-contractarians see fiduciary

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Resource Theory of Fiduciary Duty, 55 VAND. L. REV. 1399, 1497 (2002) (noting that courts use fiduciary duties to fill contractual gaps).

6. Ayres & Gertner, *supra* note 1, at 87 (arguing that unless parties contract around them, gap fillers serve as default rules in incomplete contracts).

7. *Id.* at 89–90; *see* Easterbrook & Fischel, *supra* note 1, at 426–27 (noting that a Coasian analysis of contract leads to hypothetical bargain gap fillers).

8. *See* Easterbrook & Fischel, *supra* note 1, at 430 ("[W]here there is no explicit agreement to the contrary and the relationship is a fiduciary one, the law governing fiduciary duties provides presumptive definition [of contractual provisions].").

9. Reference to "contractarians" and "anti-contractarians" means the groups so defined who are debating the nature of fiduciary duties, as this Article explains. I am not invoking other uses of the terms in contexts such as legal philosophy.

10. *See, e.g.*, Easterbrook & Fischel, *supra* note 1, at 427 (arguing that the duty of loyalty replaces detailed contractual terms and courts prescribe "the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced"); Ribstein, *supra* note 5, at 233 (suggesting that "[g]ood faith as a gap filler tailors agreements to their specific circumstances without subjecting them to inappropriate standard form duties"); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 657 (1995) (supporting the contract theory of fiduciary duty where duty of loyalty performs a gap filling role); Smith, *supra* note 5, at 1497 (arguing that fiduciary duties serve as gap fillers to suppress self-interested behavior in absence of complete specification of the fiduciary's obligations).

11. *See, e.g.*, Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 597 (1997) (arguing that the fiduciary values differ significantly from those of contract); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 891–92 (1988) (rejecting the "hypothetical bargain" approach to fiduciary duties and arguing courts' reliance on "moral obligation" justification in fiduciary duty cases indicates that judges view their role as employing high social values, not making "a judicial guess about what the parties would have agreed to"); Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 821 (1983) [hereinafter Frankel, *Fiduciary Law*] ("The courts will look to whether the arrangement formed by the parties meets the criteria for classification as fiduciary, not whether the parties intended the legal consequences of such a relation. If the criteria are satisfied, the fiduciary will be subject to the duties flowing from that relation."); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1209–11 (1995) [hereinafter Frankel, *Fiduciary Duties as Default Rules*] (rejecting the contractarian view and suggesting that fiduciaries should be subject to a separate body of rules); Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 127 (2006) (rejecting the contractarian approach where "good faith functions as an interpretive doctrine, not as a source of mandatory obligations").

relationships as involving a moral dimension that supersedes any sort of agreement the parties may have reached even in commercial contexts.[12] Contractarians, on the other hand, focus on what the parties could reasonably expect from each other given the price attached to their explicit agreement.[13]

Anti-contractarians find support in the moral language that judges use to describe fiduciary relationships. Judge Cardozo's highly moralistic language in *Meinhard v. Salmon* has been regarded as the seminal statement of the fiduciary standard.[14] Cardozo opined that courts should hold fiduciaries to a higher standard than others in the marketplace and that fiduciaries must act with a "punctilio of an honor most sensitive" and must renounce "thought of self."[15] This rhetoric influences judges, lawyers, and parties to fiduciary relationships and it creates high expectations for those relationships.

Those high expectations may be misplaced, however. Because those moral standards are amorphous and impossible to enforce, fiduciary law has evolved toward greater precision over time.[16] For the most common situations involving fiduciary duties, the law has distilled the fiduciary relationship's basic requirements to more specific rules.[17] Contractarians find support for their interpretation in this more precise definition of fiduciary duties, notwithstanding the references to imprecise moral standards that run through the case law. Although courts may offer abundant dicta about how fiduciaries should behave in an ideal world, the standard of liability fails to reach the heights of the rhetoric. More specific rules benefit fiduciary relationships by making enforcement easier and more predictable, but they do so at a cost. In particular, the greater specification compromises the benefits beneficiaries (and perhaps even society) would enjoy from a standard that would facilitate absolute trust between the parties.

Accepting the hypothetical bargain as a useful framework for understanding fiduciary enforcement, this Article adds a new dimension to the theoretical and descriptive analysis of both fiduciary law and incomplete contracting. It contributes to the incomplete contracting literature by revealing that fiduciary duties are incomplete gap fillers, that is, there is a gap in the understanding of fiduciary obligation that prevents fiduciary duties from completing fiduciary contracts. This "fiduciary gap" is the gap between the standard of fiduciary behavior the parties may agree to or justifiably expect and the relatively limited duties of loyalty and care courts will enforce. The gap prevents fiduciary law from resolving all unanticipated disputes in a way that is likely to conform to what the parties would have agreed at the outset of the relationship. Courts will not enforce a fiduciary's promise to be devoted to the beneficiary's interests. The fiduciary gap, then, is the rare

12. DeMott, *supra* note 11, at 891–92 (describing moral dimensions).

13. Easterbrook & Fischel, *supra* note 1, at 426–27. Most fiduciary scholars fill the space between these two poles, but many identify more strongly with one camp than the other and the debate has been framed in terms of the contractarian and anti-contractarian positions.

14. Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 903 (2011) (using Chief Judge Cardozo's "strong and colorful language" in describing fiduciary duties and behavioral norms); Mariana Pargendler, *Modes of Gap Filling: Good Faith and Fiduciary Duties Reconsidered*, 82 TUL. L. REV. 1315, 1344 (2008) (describing the doctrine of good faith and fiduciary duties).

15. Meinhard v. Salmon, 164 N.E. 545, 546–48 (N.Y. 1928).

16. Robert Sitkoff, *An Economic Theory of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 197 (Andrew Gold & Paul Miller eds., 2014) (forthcoming 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2367006 (describing fiduciary duties' evolution and doctrine).

17. *Id.* at 202–03 (describing "implementing rules" in agency law).

unenforceable contract term that both parties may agree to or expect or want to define their interaction, but that will not be enforced. Moreover, both parties (and society generally) are better off for that term's unenforceability.

This Article contributes to the fiduciary literature by bridging the divide between the contractarian and the anti-contractarian views. It acknowledges that the aspirational view of fiduciary relationships is one many fiduciary parties may share and that view may drive the justifiable expectations fiduciary parties have about how their agreement will be enforced. Those expectations can fit into the hypothetical bargain theory if we think of them as among the expectations courts consider in determining what terms to impose on parties to fill the gaps in contracts. However important those expectations are to the parties and to their understanding of their relationship, they cannot and should not be legally enforced in fiduciary litigation. The law cannot and should not fill the fiduciary gap. This Article imports the aspirational view of fiduciary duties from the anti-contractarian camp into the hypothetical bargain theory advanced by contractarians and finds that fiduciary duties are incomplete as gap fillers and should remain that way.

Part II of this Article introduces the opposing sides of the fiduciary debate—the contractarian and anti-contractarian views of fiduciary obligation. Part III harmonizes the opposing arguments and shows how they can coalesce to yield a theory of fiduciary obligation that leads to a more accurate and complete understanding than we currently have. The contractarian and anti-contractarian views are compatible if we acknowledge that parties may have greater expectations than courts can enforce. The hypothetical bargain can expand to include such higher moral expectations while still limiting what courts will enforce with liability to well-defined duties. Part IV reveals the "fiduciary gap" between expectation and enforcement and explains how it arises. It also presents a model of fiduciary duty enforcement that illustrates where the gaps are and how they can be narrowed. Part V then explains that the fiduciary gap is supra-legal—that the law cannot and should not completely fill it. Part VI suggests other mechanisms parties can use, apart from liability, to narrow the fiduciary gap such as more complete communication and negotiation, and reputational sanctions for untrustworthy fiduciaries. Part VI also argues that the law should get out of the way of these supra-legal mechanisms and allow them to incentivize fiduciaries to meet the higher standard beneficiaries may prefer.

II. FIDUCIARY THEORY

Fiduciary duty has at times seemed to be "one of the most elusive concepts in Anglo-American law."[18] Scholars have spent decades arguing about what fiduciary duties should be and grasping for a unifying theory that can explain all of the uses of the term "fiduciary" in each case in which it appears. Scholars on both sides of the debate have developed richly complex, admirable, and plausible theories of fiduciary obligation. This Article focuses on fiduciary relationships arising by agreement in commercial contexts.[19] This Part will consider the competing views of fiduciary obligation with regard to two fundamental questions: 1) what relationships are fiduciary? and 2) what duties does the fiduciary owe?

18. *Id.*

19. This includes trust agreements, corporate directors' relationship to a corporation, and fiduciaries engaged by beneficiaries by agreement, such as lawyers, doctors, and others. This Article does not consider non-commercial relationships such as guardian/ward relationships or parent/child relationships.

A. Fiduciary Relationships as Contracts

On one side of the debate are the scholars who believe that fiduciary relationships are a subset of contractual relationships, and that fiduciary duties are the gap fillers in those contracts.[20] In any contracting situation, the transaction costs of providing for every event that may occur or every conflict that may arise between the parties are prohibitive.[21] Negotiating parties do well to agree upon their basic expectations given the most likely constraints. Inevitably, some contracts fail to provide specific terms for problems the parties eventually confront and courts are left to fill the gaps in the contract by deciding which party's view of the contract will prevail or which party is entitled to damages.[22] To fill those gaps, courts consider what the parties would have agreed to had they negotiated about how to handle the problem ex ante.[23] Gap fillers provide courts with baseline assumptions to use in contemplating what bargain the parties would have reached. Using fiduciary duties as gap fillers sets a stage for the hypothetical bargain in which the parties agree that the fiduciary will not engage in self-dealing without permission.

1. When a Fiduciary Relationship Exists

Judge Frank Easterbrook and Daniel Fischel describe the hypothetical bargain approach in fiduciary situations as a continuum of contractual relationships.[24] They argue that all fiduciary relationships are contractual, but not all contractual relationships are fiduciary.[25] Non-fiduciary contracts exist at one end of the continuum and fiduciary contracts exist at the opposite end. In non-fiduciary relationships, the implied covenant of good faith and fair dealing fills the gaps. That requires honesty in fact and prohibits parties from engaging in purely opportunistic behavior.[26] When courts imagine what the parties might have provided had they negotiated about the gap term, they assume that the parties

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20. Easterbrook & Fischel, *supra* note 1, at 429 ("To say that express contracting is allowed is to say that the law is designed to promote the parties own perception of their joint welfare. That objective calls for filling gaps in fiduciary relations the same way courts fill gaps in other contracts."); Ribstein, *supra* note 5, at 115 ("The parties' duties often cannot be fully specified in long-term contracts. This suggests that courts should fill contracting gaps with duties to constrain the exercise of power.").

21. Easterbrook & Fischel, *supra* note 1, at 437 ("[T]he costs of specification are prohibitively high for the residual claimants.").

22. Ayres & Gertner, *supra* note 1, at 93; Easterbrook & Fischel, *supra* note 1, at 429 (describing whether fiduciary law disregards contracts).

23. Easterbrook & Fischel, *supra* note 1, at 427 ("[C]ourts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced.").

24. *Id.* at 438.

25. *Id.* at 438–39.

26. *Id.* at 438; U.C.C. § 1-201(20) (2014) (defining good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."); Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 369 (1980) ("The duty to perform in good faith applies when one party exercises discretion in performance and thereby controls the other party's anticipated benefit. The discretion-exercising party performs in good faith when it exercises discretion for any purpose within the reasonable contemplation of the parties, and in bad faith when discretion is used to recapture foregone opportunities."); DeMott, *supra* note 11, at 893 (stating that "the obligation to act in good faith limits a party's discretion to use powers or advantages that it has by virtue of an agreement or, in some instances, by virtue of law"); Smith, *supra* note 5, at 1409 (arguing "that the implied obligation of good faith and fair dealing in contract law is a form of loyalty obligation"); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 812 (1981) ("It is a kind of 'safety valve' to which judges may turn to fill gaps and qualify or limit rights otherwise arising under rules of law and specific contract language.").

would have agreed that both were required to be honest in fact and not to take opportunistic advantage of each other. The same process applies in fiduciary relationships and the duty of loyalty helps courts to fill the gap. When interpreting a fiduciary contract, courts assume that parties would have agreed that the fiduciary would be prohibited from putting self-interest or the interests of another before the beneficiary's interests.[27]

The gap fillers provide slightly different answers to the same question: given the relative positions and expectations of the parties, to what would they have agreed if they had bargained over this point? Easterbrook and Fischel argue that "[g]ood faith in contract merges into fiduciary duties, with a blur and not a line."[28] They find the distinction in the size of the gaps in the relationship. Fiduciary relationships have larger gaps than other kinds of contracts because of the different nature of the fiduciary's service to the beneficiary.[29] Beneficiaries usually retain fiduciaries because the fiduciary has greater expertise or more time to devote to a particular task.[30] The beneficiary is generally unable to monitor the fiduciary closely because she lacks the time and/or expertise to do so.[31] She relies heavily on the fiduciary's discretion and hires the fiduciary to represent her interests in performing some task. The beneficiary must leave significant gaps in the contract because so much is left to the fiduciary's knowledge and discretion. The beneficiary hires the fiduciary because she cannot explicitly describe all of the ways the fiduciary should behave in every circumstance. She can only require that the fiduciary not put any other interests ahead of the beneficiary's.

Easterbrook and Fischel find fiduciary relationships in a variety of forms.[32] They point to trustee/beneficiary, guardian/ward, attorney/client, corporate manager/investor, investment advisor/client relationships as examples.[33] The wide variety of relationships Easterbrook and Fischel classify as fiduciary distinguishes them from other contractarian scholars. Larry Ribstein, for example, argues that a fiduciary relationship only "arises from a property owner's delegation to a manager of open-ended management power over property without corresponding economic rights."[34] Similarly, Gordon Smith finds fiduciary duties are appropriate when one party gives another discretion and control over a

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27. Easterbrook & Fischel, *supra* note 1, at 439–40.

28. *Id.* at 438.

29. *See id.* at 437 (explaining the difference in costs to partners and managers in fiduciary relationships).

30. Ribstein, *supra* note 14, at 904 (noting that the beneficiary likely delegates management responsibility to the fiduciary due to the fiduciary's expertise).

31. *See* Ribstein, *supra* note 5, at 216 ("[Beneficiary] delegated control to the [fiduciary] precisely because she lacks the necessary skills and information to make accurate determinations.").

32. Easterbrook & Fischel, *supra* note 1, at 432–34.

33. Easterbrook and Fischel even claim fiduciary relationships exist where there is no duty of loyalty, which is a claim with which most scholars, including this one, disagree. *Id.* at 434. Most scholars define fiduciary relationships as relationships in which the parties agree that the duty of loyalty will bind one of the parties. *See* Frankel, *Fiduciary Law*, *supra* note 11, at 830 (noting "courts will intervene in the fiduciary relation by requiring the fiduciary to act with loyalty and skill, in the entrustor's best interests"); Ribstein, *supra* note 14, at 903–04 (supporting the definition of the fiduciary duty in terms of loyalty rather than care.); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1053 (1991) ("Fiduciary law creates a cluster of presumptive rules of conduct compendiously described as the duty of loyalty."); DeMott, *supra* note 11, at 882 (explaining that "[i]f a person in a particular relationship with another is subject to a fiduciary obligation, that person (the fiduciary) must be loyal to the interests of the other person," and that "[t]he fiduciary's duties go beyond mere fairness and honesty").

34. Ribstein, *supra* note 14, at 901.

critical resource.[35] These scholars pair a strong duty of loyalty with a requirement that the duty only be owed in limited circumstances. Easterbrook and Fischel strenuously object to this "property" theory of fiduciary obligation.[36] Instead, they define fiduciary relationships by the size of the gaps in the contract.[37]

While contractarian scholars may not always agree about whether a fiduciary relationship exists, they do agree that the parties to fiduciary relationships consent to enter them and that the parties intend to apply fiduciary duties (whether explicitly stated or not).[38] Voluntariness does not mean that the parties have to explicitly designate their relationships as fiduciary. The very nature of fiduciary relationships means that one party may be more sophisticated than the other. If explicitly calling the relationship fiduciary were required, it would be easy to take advantage of relatively unsophisticated parties and avoid fiduciary obligation entirely. Indeed, we must compare relationships that have not been called fiduciary explicitly to those that typically are fiduciary to decide whether uncertain relationships are fiduciary.[39] Though the parties may not have realized that they were entering a fiduciary relationship, they must have intended to have a relationship that fits the fiduciary paradigm and must have intended or expected that at least one of the parties could not self-deal.

2. What Duties Are Owed

The contractarian theory of fiduciary duty subscribes to the view that the only uniquely fiduciary duty is the duty of loyalty.[40] To many contractarians, owing a duty of loyalty defines the relationship as fiduciary.[41] And the duty of loyalty requires that fiduciaries not consider self-interest ahead of the beneficiary's interests in the performance of the fiduciary contract.[42] It is basically a direction not to be conflicted without the beneficiary's permission.[43]

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35. *See* Smith, *supra* note 5, at 1402 ("Even though a fiduciary may be compensated for her work, she acts on behalf of the beneficiary by considering the interests of the beneficiary and selecting actions that are designed to serve those interests, even when such actions impose costs on the fiduciary.").

36. *See* Easterbrook & Fischel, *supra* note 1, at 435 ("This common description is flat wrong, unless we treat 'property' as silly putty.").

37. *Id.* at 437.

38. *See id.* at 431 ("That legislatures, courts, and commissions treat fiduciary duties as presumptive contractual terms, promoting the parties' welfare in the absence of express contracts, is all but inevitable.").

39. *See* DeMott, *supra* note 11, at 879 ("Courts also resort to analogy in order to determine the rules applicable to a fiduciary in a particular situation."); Easterbrook & Fischel, *supra* note 1, at 425 ("The many agency relations that fall under the 'fiduciary' banner are so diverse that a single rule could not cover all without wreaking havoc. Courts have applied the term to relations as diverse as guardian–ward, attorney–client, and bank–borrower.").

40. Ribstein, *supra* note 14, at 901–02 n.7. Even anti-contractarians adopt this view. Deborah DeMott argues that the duty of care is not fiduciary in nature because everyone has some duty of care in daily interactions with the outside world. While fiduciaries, of course, owe duties of care, non-fiduciaries also owe them. DeMott, *supra* note 11, at 915.

41. Ribstein, *supra* note 14, at 901–02 n.7; Smith, *supra* note 5, at 1406.

42. Easterbrook & Fischel, *supra* note 1, at 425 ("The duty of loyalty, coupled with restitution of any gain the trustee obtains by favoring his own interest, defines a special relation."); Ribstein, *supra* note 5, at 232 (arguing that fiduciaries consent to forego self-interested behavior).

43. Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 269 (2009); Deborah DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L.

The fiduciary duty of loyalty is often framed as an amorphous standard by non-contractarians.[44] To the contrary, it is relatively specific.[45] Despite the fact that the parties cannot anticipate every way a fiduciary may be conflicted when they negotiate their contract, courts and the parties to the fiduciary contract can recognize a conflict when they see one. If a fiduciary pursues its personal benefit or the benefit of another in its performance of the fiduciary contract, it has breached its duty and is accountable to the beneficiary. Avoidance of conflicted interest without the beneficiary's permission is the only duty to which all fiduciaries are subject.

Contractarians reject the moralistic language used by anti-contractarians and some of the moralistic rhetoric used by courts. Easterbrook and Fischel argue that, "[f]iduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings."[46] Judge Posner also claims that fiduciary duties and the implied covenant of good faith and fair dealing do not and should not inject "moral principles into contract law."[47] Indeed, to the extent that they deny the importance of the moral concerns of the parties to a fiduciary contract to the agreement the parties reach, contractarians might go too far.[48] But the point they make about the doctrine's content as enforced is important and grounds the doctrine in courts' holdings rather than the potentially misleading moralistic rhetoric.[49]

Fiduciaries are also subject to various standards of care, depending on the kind of fiduciary relationship they enter and the terms of their contract.[50] I will consider the effects of the application of duties of care below, when revealing the causes of the fiduciary gap. No important distinction exists between the contractarian and the anti-contractarian view of duties of care; with a few exceptions noted below, they generally agree. The Article now turns to the anti-contractarian view of fiduciary relationships.

B. Relationships Based in Trust

Many fiduciary law scholars disagree with the contractarian view. These anti-contractarians focus their theories on notions of trust and the protection of vulnerable

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REV. 925, 926 (2006) ("Loyalty for the law's purposes . . . does not mandate an all-embracing 'thoroughgoing devotion' to the beneficiary of a fiduciary duty . . . . Instead, within the scope of their relationship, the fiduciary duty of loyalty proscribes self-dealing by the actor and other forms of self-advantaging conduct without the beneficiary's consent.").

44. Ribstein, *supra* note 5, at 210 (quoting Justice Cardozo's conception of the bounds of the fiduciary duty); Frankel, *Fiduciary Law*, *supra* note 11, at 830 (describing "loyalty" as a component of high standard of morality); Smith, *supra* note 5, at 1400 ("[C]ourts require fiduciaries to adhere to a general obligation of loyalty, but countless variations on that theme tailor the general obligation to the specific context.").

45. *See infra* Part V.C (describing the application of the duty of loyalty).

46. Easterbrook & Fischel, *supra* note 1, at 427.

47. Mkt. St. Assocs. Ltd. P'ship v. Frey, 941 F.2d 588, 595 (7th Cir. 1991).

48. *Infra* Part IV.

49. Judge Posner bemoans the moralistic rhetoric *Market Street* applied to good faith and fair dealing and expresses concern that rhetoric may cause parties to mistake non-fiduciary relationships as fiduciary. *Mkt. St.*, 941 F.2d at 593. He does not take the next step to contemplate the harm the moralistic rhetoric surrounding fiduciary duties may do.

50. *See* Easterbrook & Fischel, *supra* note 1, at 437 (describing different levels of fiduciary duties); Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 498–503 (2009) (describing different standards of review courts could apply to the duty of loyalty); Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1769–71 (2006) (describing different standards of care that doctors may be held to in medical malpractice cases).

parties.[51] They find fiduciary relationships wherever a vulnerable party is called upon to trust another and then may apply a broader definition of loyalty than would contractarians.

1. When a Fiduciary Relationship Exists

Anti-contractarian theories of fiduciary relationships focus on the capaciousness of the term "fiduciary" and the wide variety of relationships in which courts have found fiduciary obligations.[52] To find common ground among all putatively fiduciary relationships is daunting if not quixotic.[53] Overall, the theories focus on trust. Tamar Frankel's entrustment theory of fiduciary relationships provides a basic anti-contractarian framework.[54] According to the entrustment theory, fiduciary relationships arise where the entrustor (beneficiary) is vulnerable to and dependent on the fiduciary who holds money or power for the beneficiary's benefit.[55] Deborah DeMott finds a fiduciary relationship when "the course of the parties' dealings over time should justify an expectation of loyalty when the relationship has deepened into one in which one party is invited to and does repose substantial trust in the other's fidelity to the trusting party's interests or joint interests of the parties."[56]

Anti-contractarians are comfortable extending fiduciary obligation to situations where the parties have not agreed to be in a fiduciary relationship and even did not intend the consequences of a fiduciary relationship upon beginning their interaction.[57] This comfort comes in part from cases in which courts have applied fiduciary duties where parties may not have expected those duties to apply. In those cases, the anti-contractarians point out, the parties often did not have a contractual relationship at all and even if they did, they did not necessarily expect fiduciary duties to be apposite.[58] In light of those cases and cases in which a beneficiary to a fiduciary duty would not be competent to enter into a contract,[59]

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51. *See, e.g.*, DeMott, *supra* note 11, at 902 ("[P]arty's vulnerability to the fiduciary's abuse of power or influence conventionally justifies the imposition of fiduciary obligation."); Frankel, *Fiduciary Law*, *supra* note 11, at 808 (demonstrating that "protective mechanisms outside of fiduciary law cannot adequately eliminate . . . risk to the [beneficiary]"); Gold, *supra* note 50, at 511 (noting that an important function of loyal behavior is the means to trust each other).

52. DeMott, *supra* note 11, at 879 (arguing that the traditional way of developing fiduciary law is insufficient and inconsistent); Frankel, *Fiduciary Law*, *supra* note 11, at 804 ("Because of the wide range of situations in which the obligation may arise, the law of fiduciary obligation has developed through analogy to contexts in which the obligation conventionally applies.").

53. DeMott, *supra* note 11, at 879 ("Fiduciary obligation is one of the most elusive concepts in Anglo-American law.").

54. *See generally* Tamar Frankel, *Fiduciary Law in the Twenty-First Century*, 91 B.U. L. REV. 1289 (2011) (asserting that fiduciary law regulated relationships are based on trust).

55. *Id.* at 1293 (describing a fiduciary relationship's components).

56. DeMott, *supra* note 43, at 940.

57. DeMott, *supra* note 11, at 887 ("[O]nce a court concludes that a particular relationship has a fiduciary character, the parties' manifest intention does not control their obligations to each other as dispositively as it does under a contract analysis.").

58. *See, e.g.*, *id.* at 882–83 (citing an example from a Seventh Circuit case, Jordan v. Duff & Phelps, Inc., 815 F.2d 429 (7th Cir. 1987), *cert. denied*, 108 U.S. 1067 (1988) where the court found a fiduciary relationship between a closely held corporation and its employee–shareholder where no express employment contract existed).

59. Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1241 ("To bargain in the contract mode, entrustors must be capable of independent will.").

anti-contractarians argue that the contract is not an accurate foundation for fiduciary obligation.[60]

Rather than looking for agreement or consent to discover fiduciary relationships, anti-contractarians instead focus on whether one party was vulnerable in light of the other's power and infer fiduciary obligation where the powerful actor abused its position.[61] Anti-contractarian fiduciary theory holds that we should find fiduciary duties where a powerful party can take advantage of a weak one and then use those duties to protect the weaker party.[62] Protection of vulnerable parties will encourage them to enter into socially and economically beneficial transactions where distrust of those who might take advantage of them may otherwise be too great.[63]

Fiduciary duties, then, encourage relationships between parties of different degrees of knowledge or sophistication.[64] A relationship is fiduciary, according to anti-contractarians, if it would be inequitable to allow it to exist otherwise, or if the vulnerable party would refuse to enter the relationship without fiduciary protection.[65] In this vein, anti-contractarian theorists emphasize that the vulnerable party is often not on an equal footing with the more powerful party, so we should generally assume that fiduciary duties are not waivable.[66] It would undermine the purpose of fiduciary duties, and the very nature of the fiduciary relationship, as defined by anti-contractarians, to allow a beneficiary to waive the very duties it needed to enter the relationship in the first place.[67]

2. What Duties the Fiduciary Owes

If anti-contractarians are willing to find fiduciary relationships in a variety of situations, even when the parties do not expect or intend to be in a fiduciary relationship, it is important to fix an understanding of what duties apply upon that finding. Of course, a strong duty of loyalty is the most important duty, and again, the only uniquely fiduciary duty. As with the contractarian theory, and indeed, an uncontroversial understanding of fiduciary cases, the applicable duty of care will vary by the type of fiduciary relationship

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60. Frankel, *Fiduciary Law*, *supra* note 11, at 799–802 ("A contract society values freedom and independence highly, but it provides little security for its members . . . . [Whereas a] fiduciary society attempts to maximize both the satisfaction of needs and the protection of freedom."); DeMott, *supra* note 11, at 892 (contrasting fiduciary obligation with contract law).

61. Frankel, *Fiduciary Law*, *supra* note 11, at 808–16 (describing the potential abuses of power that exist in fiduciary relationships).

62. *Id.* at 816 ("Because the entrustor cannot satisfactorily protect himself . . . the law must intervene to protect him from abuse of power").

63. *Id.* at 833 (arguing that since our society values fiduciary relationships, the law should regulate the fiduciary to discover and minimize the potential risks to the entrustor); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1803 (2001) (arguing that those who have high trust in others are more likely to enter potentially rewarding relationships that entail a high degree of vulnerability).

64. Frankel, *Fiduciary Law*, *supra* note 11, at 833; Blair & Stout, *supra* note 63, at 1739–40.

65. DeMott, *supra* note 11, at 909–10 ("[C]ourts impose fiduciary constraints whenever one person's discretion ought to be controlled because of characteristics of that person's relationship with another.").

66. Frankel, *Fiduciary Law*, *supra* note 11, at 822 (emphasizing that not even an explicit contractual waiver provision will remove fiduciary relations from the courts' supervision); DeMott, *supra* note 11, at 887 ("[A] fiduciary obligation may operate independently of the legal consequences of the parties' express agreement, however comprehensive the agreement may be.").

67. Frankel, *Fiduciary Law*, *supra* note 11, at 822; DeMott, *supra* note 11, at 887.

and will depend more on what kind of well-settled relationship the fiduciary relation in question resembles.

Some anti-contractarians recognize a continuum of loyalty that may be required of a fiduciary.[68] At one end of the continuum is a "nonbetrayal" duty, or a duty to refrain from self-dealing. At the other end is affirmative devotion, which prohibits dishonest or manipulative behavior even where self-dealing is not present.[69] Without placing themselves in either the contractarian or anti-contractarian camp, Hill and McDonnell argue that the duty of loyalty should be broadly defined to require that a fiduciary "actively pursue the best interests" of the beneficiary, a standard that combines the duties of care and loyalty into one fiduciary duty that more closely resembles devotion.[70] Bringing the duty of care within the duty of loyalty purports to require the fiduciary to be selfless even with regard to how much time and attention she devotes to the fiduciary task. Hill and McDonnell argue that one cannot properly be considered a fiduciary if one must not be careful and attentive and competent.[71]

Most scholars, even on the anti-contractarian side of the debate, would agree that affirmative devotion is not required of a fiduciary, and courts do not hold fiduciaries to that standard in enforcing fiduciary obligations.[72] Still, some see that standard in the moralistic rhetoric of courts' opinions and wonder if that rhetoric, though not yet the basis for liability or enforcement, should be considered part of the standard.[73] Even proponents of a standard of loyalty that contemplates devotion acknowledge that devotion requires a high degree of care, one that courts do not readily enforce.[74]

Tamar Frankel's entrustment theory focuses on three beneficiary expectations that the law enforces through fiduciary law. First, the law prohibits self-dealing without the beneficiary's permission.[75] Second, courts may decide to remove a fiduciary even when the beneficiary cannot.[76] Third, the law will enforce the prohibition against self-dealing even when the beneficiary should have known that self-dealing was possible because of known individual traits of the trusted party.[77] Frankel's theory combines the prohibition

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68. Gold, *supra* note 50, at 489 (citing Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27 (2003)).

69. *Id.*

70. Claire A. Hill & Brett H. McDonnell, Stone v. Ritter *and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1779 (2007) (discussing corporate fiduciary duties and arguing that the duty of loyalty should also include the duty of care to form one fiduciary duty).

71. *Id.*

72. *See, e.g.*, DeMott, *Breach of Fiduciary Duty*, *supra* note 43, at 926 ("Loyalty for the law's purposes . . . does not mandate an all-embracing 'thoroughgoing devotion' to the beneficiary of a fiduciary duty."); Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1229 ("The 'goodness' expected of fiduciaries consists of refraining from taking what is not theirs, without permission.").

73. Gold, *supra* note 50, at 503; *but see* Easterbrook & Fischel, *supra* note 1, at 429 (emphasizing that we must look at what courts *do* rather than what they say in dicta).

74. Gold, *supra* note 50, at 488 (describing Professor Lyman Johnson's argument that "moral ideas of loyalty should play a greater role in corporate law, at least if courts continue to use the language of loyalty in support of their decisions"). For more on this gap between intense loyalty and the enforced standard of care, see *infra* Part IV.D.

75. Frankel, *Fiduciary Law*, *supra* note 11, at 824.

76. *Id.*

77. *Id.* at 824–25 ("[T]he law entitles the entrustor to rely on the fiduciary's trustworthiness. The entrustor is therefore not required to show that he actually relied on the fiduciary, and the fiduciary has the burden of justifying self-dealing transactions.").

against self-dealing with the object of protecting the beneficiary's vulnerable position. The additional awareness of the beneficiary's vulnerability and willingness to protect the beneficiary even from herself distinguishes the entrustment theory from the contractarian theory without adding additional obligations for the fiduciary to fulfill. Frankel does not add a duty—she simply argues that the duty of loyalty applies more broadly, sometimes without regard for the parties' expectations.

Deborah DeMott also defines the duty of loyalty as a prohibition against self-dealing. She argues that the duty of loyalty does not require devotion but rather, "proscribes self-dealing by the actor and other forms of self-advantaging conduct without the beneficiary's consent."[78] She focuses her theory on protecting the beneficiary's justifiable expectation of loyalty, but does not seek to expand the duty beyond a prohibition against self-dealing.

DeMott's view provides a useful bridge to the contractarian theory: that fiduciary law should seek, to the extent possible, to protect the justifiable expectations of the parties. The degree to which the law can enforce and protect those expectations and our understanding of what those justifiable expectations are reveals both the power and the limits of fiduciary law. In considering the parties' hypothetical bargain, we must account for their expectations, but the law will not enforce all of the parties' expectations and may not even enforce all of the bargains the parties would have been willing to make.

III. Harmonizing the Theories and Revealing The Fiduciary Gap

In many respects, the contractarians and anti-contractarians seem to be talking past each other. Contractarians assert that all fiduciary relationships must be based on a voluntary interaction that at least resembles a contract, and anti-contractarians point out that such a strict model fails to explain the many cases where fiduciary duties are applied without an express agreement or a contract containing a fiduciary term. They seem to agree, for the most part, that the duty of loyalty is a duty to refrain from self-dealing without the beneficiary's permission (and that that is the defining duty of fiduciary relationships) but disagree about how and, in some circumstances, to what extent, that duty should apply.

In fact, there is only a debate at the margins. Almost everyone agrees that a fiduciary relationship exists when parties voluntarily enter certain relationships.[79] It is also uncontroversial that a fiduciary relationship exists when two parties agreed that one will be bound by fiduciary duties in its performance of the contract. Both sides also agree that the duty of loyalty is the defining fiduciary duty and that it simply prohibits self-dealing by the fiduciary without the beneficiary's permission.

The easy cases include those where the parties explicitly agree that fiduciary duties will fill the gaps in their contract. Anti-contractarians argue that contract law cannot explain fiduciary law because fiduciary remedies and procedures are different from contract law.[80] That argument ignores the possibility that parties can voluntarily import the

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78. DeMott, *supra* note 43, at 926.

79. These include trustee/trust beneficiary, attorney/client, guardian/ward, doctor/patient, and corporate director/corporation relationships, among others. Easterbrook & Fischel, *supra* note 1, at 432–33; Frankel, *Fiduciary Law*, *supra* note 11, at 830. Larry Ribstein argues, however, that there must be a delegation of discretion or control over the beneficiary's property before a fiduciary relationship would be appropriate, so he limits the fiduciary duties' application more severely than other scholars on either side of the debate. Ribstein, *supra* note 14, at 901.

80. DeMott, *supra* note 11, at 888.

body of fiduciary law to fill the gaps in their contracts. Parties can agree to remedies by contract and can also agree on a body of law to govern their contract.[81] When they agree to enter into a fiduciary relationship, they agree that the fiduciary law and the application of the duty of loyalty will determine how their relationship is enforced in the event an unanticipated conflict occurs.

The marginal cases are still difficult, however, and contractarians and anti-contractarians disagree mightily about when to find a fiduciary relationship where one is not obvious. They also differ in some instances as to the breadth of the duty of loyalty. Some scholars on both sides subscribe to Cardozo's language in *Meinhard* that the duty of loyalty requires the fiduciary to "renounce" all "thought of self."[82] Others stick to a simpler construction that prohibits direct financial conflicts of interest without the beneficiary's permission.[83] In these difficult cases at the margins of both key questions, a theory would be useful both to predict and explain the most common application of fiduciary doctrine. This Article demonstrates that the most useful model for fiduciary obligation combines insights from both the contractarian and anti-contractarian camps.

DeMott's theory that a fiduciary relationship arises when one party has a justifiable expectation that the other will act in a manner consistent with the fiduciary duty of loyalty ties in nicely with the contractarian theory of fiduciary obligation and each theory may improve the other. Both theories focus on the parties' expectations. The hypothetical bargain model advanced by many contractarians fills the gaps in fiduciary relationships by imposing on the parties the agreement they would have reached had they initially bargained about the conflict.[84] It is important to understand the parties' intentions and expectations when forming the agreement to know what drew them into the relationship and how they expected it to proceed.

Easterbrook and Fischel reject that broader application of fiduciary duties by arguing that the party alleged to be in the fiduciary position would charge so much if fiduciary duties were imposed in some situations that the cost would prevent the beneficiary from entering the relationship in the first place.[85] They fail to consider all of the beneficiary's perspective, however. Some beneficiaries may not be willing to enter the relationship at all if the other party is allowed to advance conflicted interests. The beneficiary's justifiable expectation that the other party either would not engage in self-dealing or would be prohibited from doing so is an important part of what induced the beneficiary to enter the arrangement in the first place. Honoring that expectation, and what caused it, is part of truly understanding what the parties would have agreed with regard to the gap.

The basis for the trusting party's expectations is important. It may be that the trusting party[86] was mistaken and had actually received explicit disclosure that a duty of loyalty

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81. *See generally* ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET (2009) (exploring the ability of parties to draft choice of law provisions).

82. Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928); Ribstein, *supra* note 14, at 903; Gold, *supra* note 50, at 459; Smith, *supra* note 5, at 1406–07.

83. Easterbrook & Fischel, *supra* note 1, at 426; Alces, *supra* note 43, at 269 (arguing that fiduciaries shall be prohibited from financial conflicts of interest and "[o]nly[] conflicts of interest that are specifically approved by the corporation will be allowed").

84. Easterbrook & Fischel, *supra* note 1, at 427, 438–39.

85. *Id.* at 445.

86. The trusting party is the party that would be the beneficiary if the relationship were deemed fiduciary.

would not apply. Perhaps, on the other hand, the trusted party[87] was ambiguous or led the beneficiary to believe he would be acting on the beneficiary's behalf or that the beneficiary could and should trust in the fiduciary's loyalty. If the trusted party tries in any way to trade on notions of loyalty, then it stands to reason that loyalty should be an implied term of the contract, or should govern the resolution of conflicts in the relationship should they arise, for it is a term the parties would have adopted had they explicitly bargained over it ex ante. DeMott captures this in her theory by noting that the "course of the parties' dealings over time should justify an expectation of loyalty when the relationship has deepened into one in which one party is invited to and does repose substantial trust in the other's fidelity to the trusting party's interests or joint interests of the parties."[88]

DeMott brings to light examples of fiduciary cases in which the court considers the beneficiary's justifiable expectations in its reasoning. She seems to sympathize with the vulnerable party and to favor its expectations,[89] but careful reading of the results of the cases reveals they actually fit better with the hypothetical bargain theory. Indeed, in honor of the hypothetical bargain theory, the courts did not apply fiduciary duties where it was clear that only one party expected, or hoped that, a duty of loyalty would apply. Where the trusted party was not aware of an expectation and had no reason to expect it owed a duty of loyalty, the court did not find a fiduciary relationship.

For example, DeMott analyzes *Groob v. Keybank*,[90] where the plaintiffs applied for a loan at a bank. The bank denied their application, but the loan officer used the information contained in the application to alert friends to a business opportunity, which the friends then exploited with the help of a loan from the bank.[91] The majority of a divided court held that it would not impose a fiduciary duty on the bank because the bank did not expect that its customers would repose trust in it when applying for loans.[92] The court held that the bank has to be aware of the trust the customer is placing in it before that trust will lead to a fiduciary relationship.[93] In other words, the expectation of loyalty must be the term the parties would have *agreed* to.

DeMott sides with the dissent, focusing on the customer's trust in giving confidential information to the bank.[94] She argues that the customer may not have given the information to the bank had it known or expected that the bank could or would use it to make a loan that would be more personally beneficial to the loan officer.[95] In fact, we cannot be entirely sure what agreement the parties would have reached. If the parties had negotiated about the manner in which the bank could use the information, the customer may have refused to divulge it, it may have given the information in exchange for the chance to be considered

87. The trusted party is the party that would be the fiduciary if the relationship were deemed fiduciary.

88. DeMott, *supra* note 43, at 940.

89. When a court held that a bank was not a fiduciary of loan applicants and so loan officers were not liable for using information in the loan application for personal benefit, DeMott argues: "Loan officers function as necessary intermediaries between loan applicants and lending institutions, such that a loan applicant may justifiably believe that confidential information transmitted to the institution via its loan officer will not be diverted to the officer's own purposes." DeMott, *supra* note 43, at 948.

90. Groob v. Keybank, 843 N.E. 2d 1170 (Ohio 2006).

91. *Id.* at 1172.

92. *Id.* at 1175.

93. *Id.*

94. DeMott, *supra* note 43, at 948.

95. *Id.*

for a loan, or perhaps the customer would have shopped for a bank that would agree to preserve the confidentiality of its business plan.

There is a strong argument, however, that the customer knew that the bank was not only not necessarily on its side, but also not its fiduciary. The purpose of the customer's interaction with the bank was to obtain a loan. The bank was evaluating whether to give the customer a loan, but could decide to deny the application if it found that the loan was not in the bank's interests. That is the opposite of an understanding that the bank would operate only in the *customer*'s interest in its actions in evaluating the loan. If the customer expected the bank to act only to further the bank's own financial interest, it could not have justifiably expected that the bank was its fiduciary. While customers may indeed find banks willing to agree to keep application details confidential, they should not assume such selfless confidentiality in a relationship where neither party expects to be able to apply a duty of loyalty. Until, and even, perhaps, after the loan is granted, the customer and the bank are protecting and advancing competing interests in many circumstances (which the customer would discover if it ever could not or did not want to repay the loan).

On the other hand, where promised loyalty induces a trusting party to enter a relationship, courts may honor the party's expectation of a duty of loyalty. For example, the court found a duty of loyalty in *Chou v. University of Chicago*,[96] where a graduate student agreed to work in a professor's lab and designed inventions that eventually earned lucrative patents. While the student understood that the university would hold the patents to her inventions, the professor promised her that she would be properly credited on the patent applications.[97] The professor, however, did not credit the student and instead earned financial returns that the student would have been entitled to, had she been properly credited.[98] The court held in the student's favor, citing both the professor's position of authority and the student's relative vulnerability.[99] Here, the professor traded on his promise to properly acknowledge the student for her work. Perhaps the student could have, and indeed would have, decided to work for another lab had she not received such assurances. One may even argue there was no gap in their agreement. Even though it was not part of the student's formal agreement with the university, the student and her professor, the university's representative, bargained about what would happen when patent applications were filed and the professor promised the student would be credited. That exchange helps us to fill in the gaps in the parties' agreement by telling us what they likely intended to happen in the situation that gave rise to their conflict.

Both the contractarian and anti-contractarian views consider the parties' expectations in the potential fiduciary relationship, but each sympathizes more strongly with one side than the other. Contractarians focus on costs fiduciary duties would impose on the party having the duty,[100] while the anti-contractarians pay more attention to the benefits of fiduciary duties to the vulnerable party and the vulnerable party's need for protection.[101] The best description of fiduciary law probably lies somewhere in the middle, that is, both

96. Chou v. Univ. of Chi., 254 F.3d 1347 (Fed. Cir. 2001).

97. *Id.* at 1362.

98. *Id.* at 1363.

99. *Id.* at 1362–63.

100. Easterbrook & Fischel, *supra* note 1, at 427 (concluding that the "fiduciary" relationship is characterized by exceptionally high costs of specification and monitoring).

101. Frankel, *Fiduciary Law*, *supra* note 11, at 824 (arguing that the court should regulate the fiduciary if adequate protection from fiduciary abuse of power is not provided).

parties' desires and expectations must be taken into account because both parties were considering their own preferences when they reached an agreement. Both parties' expectations and intentions will shape our understanding of what agreement they would have reached when we need to fill in a gap in their relationship. To err in favor of one side or the other is to err in a costly way. The law enforces the terms, whether explicit or implied, that were important in making the interaction possible. Sometimes that term will be the enforcement of a duty of loyalty and sometimes it will be one that allows both parties to work only for their own advantage.

IV. The Fiduciary Gap: The Space Between Duties and Expectations

The expectations the parties may have about how they will treat each other will not necessarily lead to legally enforceable duties. Expectations alone are not enough. While proponents of both theories would like to honor those expectations, there are limits to the kinds of behaviors the law can, or is willing to, enforce. That space between what the parties might expect and what the courts are willing to enforce is the fiduciary gap. The law cannot and will not fill that space; that space gives rise to most of the debate about the theory of fiduciary law. This Part describes the fiduciary gap and models the enforcement of fiduciary duties to show the gap that the law cannot fill exists and how it might arise.

I begin by presenting differing expectations trusting parties may have when entering a fiduciary relationship. These expectations exist on a continuum between low and high expectations of the trusted party. Understanding these different expectations can help us appreciate the limitations the law faces in promoting or governing trusting relationships. I will then explore the ways in which the law's response to problems in trusting relationships is limited. Because the law cannot enforce the full extent of the contracting parties' expectations, fiduciary contracts contain gaps the law cannot fill. Finally, I will present models of judicial responses to fiduciary relationships, highlighting where the fiduciary gap remains, and advancing a theory about how courts interpret fiduciary contracts.

A. High Versus Low Expectations

Anti-contractarians emphasize that fiduciary relationships are relationships based in trust and that fiduciary duties are appropriate where we want vulnerable parties to trust in counterparties to act on their behalf.[102] Fiduciary relationships do arise in circumstances where it would be valuable for beneficiaries to be able to trust their fiduciaries. Trust makes such relationships more comfortable for beneficiaries and makes them more likely to enter into those economically beneficial relationships. "Trust" is not a simple concept, however, and for notions of fiduciary trust to be meaningful, we must consider what it is that beneficiaries are trusting in, what that trust means, and how trust drives the expectations of the parties in a fiduciary contract.

In trying to meaningfully define and model different types of trust, Claire Hill and Erin O'Hara identified two kinds of trust that drive human interaction: "trust in" and "trust that."[103] "Trust in" refers to a belief that "a person will act in a certain manner, either because she is motivated by our well-being or because of her values."[104] "Trust in" calls

102. *Supra* Part I.B.
103. Hill & O'Hara, *supra* note 50, at 1721.
104. *Id*.

for intrinsic motivation, the "desire to perform the task for its own sake."[105] "Trust that" predicts how a person will likely behave because of a requirement or incentive.[106] The law promotes "trust that" other actors will behave as agreed, but cannot build the character necessary to justify "trust in." "Trust that" relies on extrinsic motivations for the trusted party, "contingent rewards"[107] that provide external incentives to perform in a certain way. The law can give a beneficiary confidence that she can "trust that" a fiduciary will behave as agreed and as required by the duties the law enforces, but it cannot support a beneficiary's "trust that" the fiduciary will be intrinsically motivated to rise to a higher standard of loyalty or devotion in performing the contract.

Of course, intrinsic motivations overlap with extrinsic motivations just as "trust in" overlaps with "trust that." The degree to which someone responds to extrinsic motivations or external incentives that allow us to "trust that" they will behave as encouraged or required is driven by their intrinsic motivations and their character. It is impossible to truly divorce the two, yet this dichotomy describes useful observations about what may drive fiduciary behavior and what beneficiaries may be thinking or hoping when they decide to trust a fiduciary.

Entrusting a fiduciary with a sensitive personal or financial matter would be more comfortable if a beneficiary could be confident that the fiduciary were intrinsically motivated to work hard and carefully in the pursuit of the beneficiary's best interests. The beneficiary would like to hire someone more likely to exceed the law's bare requirements. Those character traits are hard to define and identify, however. For the same reasons such standards are impossible to enforce, it is very difficult to reliably identify a fiduciary who would meet them. Nevertheless, a standard of devotion may be a term both parties could agree to, based to a large extent on what it means to the two of them, and it may be what beneficiaries want to find when deciding which fiduciary to choose.

Some beneficiaries believe or hope they have found such a fiduciary and enter the fiduciary relationship trusting in the fiduciary to be devoted to their best interests and to do their absolute best to selflessly work to advance the beneficiary's cause. These beneficiaries have what I will refer to as "high expectations." They expect more than the law will actually enforce and may not have entered the relationship if they understood the limits of legal enforcement or that they may have no recourse if they are harmed by the fiduciary's underperformance. These high expectations give rise to the fiduciary gap. Courts cannot impose the devotion term on parties, even though it may be part of the bargain they would have reached had they negotiated about the point and even if it is a term they actually agreed upon. The fiduciary gap this Article identifies is the gap between the trusting party's high expectations and the relatively limited duties the law will enforce against fiduciaries.

Other potential beneficiaries may have relatively "low expectations." Low expectations are based on what duties the law will enforce. A trusting party with low expectations only expects the fiduciary to behave as the law or other apposite incentives or sanctions require and understands she is vulnerable to injuries that will not be remedied for harms caused by fiduciary behavior that meets, but does not exceed, the legal standard.

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105. Roland Bénabou & Jean Tirole, *Intrinsic and Extrinsic Motivation*, 70 REV. OF ECON. STUD. 489, 490 (2003).

106. Hill & O'Hara, supra note 50, at 1721, 1724–45.

107. Bénabou & Tirole, *supra* note 105, at 490.

Trusting parties may have low expectations because they are generally more cynical or guarded or because they simply understand the limits of the duty of loyalty. More sophisticated parties seem more likely to have lower expectations for that reason. Better communication about what standard the trusted party believes it will be held to and meet would also lead to expectations that are closer to or at the standard courts will enforce when reviewing the relationship should litigation arise. Relationships marked by lower beneficiary expectations are more likely to be those in which the hypothetical bargain will be effective to fill any gaps and are less likely to be affected by the fiduciary gap.

A trusting party may have developed high expectations because a trusted party traded on a promise of delivering a superior level of devotion and on signals that the trusted party was worthy of "trust in," that the trusted party was intrinsically motivated to do a superior job for the trusting party. High expectations may also come from a common understanding that a fiduciary's role is defined by being held to a higher standard than others in the marketplace and that being a fiduciary means being worthy of a beneficiary's trust and confidence. That understanding is common among anti-contractarian scholars and is also supported by moralistic rhetoric in fiduciary opinions.

Moralistic rhetoric in fiduciary cases has given everyone from judges to lawyers to fiduciary law scholars the impression that the beliefs supporting high expectations are justifiable expectations the law will enforce. Judge Cardozo's language in *Meinhard v. Salmon* is widely considered the appropriate standard of fiduciary conduct. Cardozo stated that a fiduciary's "thought of self was to be renounced, however hard the abnegation,"[108] and that "[n]ot honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[109] Some expect that fiduciaries are required not only to refrain from self-dealing, but to actively and enthusiastically pursue the beneficiary's interest.[110] Going even further, the rhetoric in recent Delaware Supreme Court cases describing what would constitute bad faith behavior has mentioned (in dicta, so without finding liability) that the requirement that corporate directors act in good faith to comply with their duty of loyalty may indeed require something akin to "affirmative attention and devotion."[111] The ideal of devotion that the court refers to contemplates affirmative devotion to another's well-being.[112] Those who advocate for a broad conception of the duty of loyalty argue that it requires fiduciaries to be "true," meaning they must be honest, reliable, and not manipulative or deceitful within the fiduciary relationship.[113] Combining the two ideals, fiduciaries should be honest, honorable, reliable and committed to the beneficiary's well-being. To require a fiduciary to be devoted to the beneficiary's well-being—to go beyond

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

109. *Id.* at 546.

110. For example, a lawyer's obligation to provide "zealous advocacy." MODEL RULES OF PROF'L CONDUCT, Preamble (2013).

111. Gold, *supra* note 50, at 488 (discussing *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 760 n.487 (Del. Ch. 2005)); *see also id.* ("While Delaware cases recognize both types of loyalty, an emphasis on affirmative devotion opens up a much more extensive and demanding view of loyalty than corporate law has sometimes recognized.").

112. Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 37–42 (2003) (arguing that loyalty is not simply a restraint or inhibition on self-interest, it is to favor another such as a "spouse, nation, and a jealous God").

113. Gold, *supra* note 50, at 492 ("The view that a broken agreement between the board and the corporation's shareholders is an act of disloyalty tracks the view that a loyal individual 'takes his promises and commitments seriously.'").

simply avoiding conflicted interest—is to enforce high expectations and to encourage a high degree of trust in fiduciaries. That policy would seek to encourage or require intrinsic motivations through extrinsic means.[114]

Trust may be useful, but not all trust is optimal.[115] That is, we can make mistakes both by over-trusting and under-trusting.[116] Over-trusting can lead to injury and under-trusting can lead to excessive monitoring and negotiating costs, as well as possible ill-will between contracting parties.[117] The fiduciary rhetoric that would expand fiduciary obligation beyond a duty to refrain from self-dealing, and an applicable duty of care to a requirement that fiduciaries be devoted to the well-being of their beneficiaries, encourages beneficiaries to over trust. The best the law can do to promote trust in arm's length transactions between strangers is to create incentives and sanctions that make the desirable behavior more likely while enforcing a well-defined standard of behavior with liability. Beneficiaries should expect that the fiduciary will not do something in breach of enforceable fiduciary duties. The beneficiary's *trust*, then, should be limited to the extant extrinsic incentives applicable to the fiduciary (the beneficiary can *hope* all she wants). Trusting that a fiduciary will be devoted to the beneficiary is only appropriate if the law can enforce that standard of devotion. Not only can the law not enforce a standard of devotion with liability, it should not. A closer examination of the application of fiduciary duties will demonstrate why a fiduciary standard of devotion is neither realistic nor advisable.

B. The Limits of the Law—The Duty of Care

A duty of care is an important element of devotion. One cannot be devoted to another's best interests without performing very carefully and competently on the other's behalf and in the other's interest. In order to be truly devoted, a fiduciary would spend a tremendous amount of time and effort working for each beneficiary, as though her own well-being depended on the outcome.[118] This is not what fiduciary law requires.[119]

Most fiduciaries are held to a negligence standard of care,[120] though some fiduciaries are held only to a gross negligence standard.[121] When the beneficiary charges a fiduciary with making decisions on her behalf, some kind of business judgment rule will apply. That

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114. However, research suggests that extrinsic incentives may diminish intrinsic motivation, so that one is not a reliable path to the other. Bénabou & Tirole, *supra* note 105, at 490.

115. Hill & O'Hara, *supra* note 50, at 1734.

116. *Id.*

117. *Id.* at 1723, 1735.

118. Gold, *supra* note 50, at 488–89 (describing the importance of "being true" loyalty).

119. DeMott, *supra* note 43, at 926 ("Loyalty . . . does not mandate an all-embracing 'thoroughgoing devotion' to the beneficiary of a fiduciary duty."); Easterbrook & Fischel, *supra* note 1, at 437 (illustrating the obvious differentiation of duties owed by fiduciaries by explaining that "[a]ttorneys owe their clients strong duties of loyalty because clients have a hard time monitoring their effort or using the results obtained as a clue to that effort and devotion, but brokers do not owe their clients similar duties because market prices provide a low-cost means of measuring both effort and success"); Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1211 (explaining that fiduciaries are able to act negligently and in conflict of interest unless there is an express or implied prohibition from doing so).

120. Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1213; Easterbrook & Fischel, *supra* note 1, at 441.

121. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 53 (Del. 2006) (illustrating that to find that corporate directors violated their duty of care, they must have acted with gross negligence).

is, the fiduciary will not be held liable for a bad decision, or one that leads to a bad outcome for the beneficiary, as long as the fiduciary made a good faith judgment after adequately informing herself about the decision at hand.[122] The law of trusts uses a "prudent man standard" that requires that the trustee use the degree of care a prudent man would use in making the decision for himself.

Both fiduciaries and beneficiaries benefit from these limits. It would be unwise to impose liability for decisions simply because they lead to poor outcomes because any decision, even a careful one that seems wise at the time, might not turn out as planned. It is impossible to predict the future, so assigning liability with the benefit of hindsight would mean that almost no one would be willing to become a fiduciary. Punishing the inability to predict the future accurately would also chill risk-taking by fiduciaries that may prove profitable for beneficiaries[123] and would, in many cases, lead to the kind of conservatism in decision making that would not require particular expertise to execute. For these reasons, some kind of business judgment rule, or limitation of liability for substantively bad decisions, is a determinant of a fiduciary's duty of care.

Employing a business judgment rule means that the court cannot hold a fiduciary responsible for having honest but bad judgment.[124] Not being smart or competent are not sufficient grounds for liability. A court will not hold a fiduciary liable for substantively bad decisions, only uninformed ones,[125] or, in the case of trusts, decisions that take too big a risk.[126] A court will also not require a fiduciary to renounce all thought of self[127] when deciding how much time or care to devote to a fiduciary task.[128] Not only would it be impossible for a fiduciary to devote all of her time to her tasks on behalf of the beneficiary,[129] but such devotion would not be a feasible business model for fiduciaries or beneficiaries. The costs of such devotion would be prohibitively high[130] and a fiduciary would not be able to develop the requisite expertise if she were to limit herself to one engagement at a time.

Affirmative devotion would require the enforcement of a strict standard of care. One cannot be devoted and careless.[131] Devotion implies a dedication of time and effort above and beyond the minimum standard of reasonableness. Yet, the minimum standard of reasonableness is the most that a court will enforce. While fiduciaries may advertise their extreme care, dedication, expertise, and superior judgment and a beneficiary may rely on the expectation that the fiduciary will be devoted to her cause when entering the relationship, devotion is not an enforceable term. It is impossible to measure objectively

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122. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 124 (Del. Ch. 2009) (stating that in corporate law, "[t]he business judgment rule 'is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company'").

123. Langbein, *supra* note 10, at 642.

124. *See In re Citigroup Inc.*, 964 A.2d at 124 (discussing the business judgment rule's presumptions).

125. *See generally In re* Walt Disney Co. Derivative Litig., 907 A. 2d 693 (Del. Ch. 2005) (holding a company did not breach their fiduciary duty for terminating its president, despite not using ideal practices).

126. Langbein, *supra* note 10, at 645–46.

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

128. Ribstein, *supra* note 14, at 908.

129. *Id.*

130. Easterbrook & Fischel, *supra* note 1, at 427 (characterizing the fiduciary relation as a contractual relationship with unusually high costs of specification and monitoring).

131. Hill & McDonnell, *supra* note 70, at 1779.

and impossible to apply equitably with the benefit of hindsight. It is also an unrealistic and undesirable term for economic transactions, even those in which a duty of loyalty would be useful. When parties justifiably expect devotion, some degree of behavior approximating devotion, or something that goes beyond the bare bones of fiduciary duties as enforced by courts and rely on that expectation in entering fiduciary relationships, then a gap in enforcement of their contract exists between what they expect and what courts will enforce. Their expectations exceed the maximum standard the law will enforce and the law cannot and should not fill that gap. The parties can agree to whatever terms they want and can even agree that the fiduciary will be devoted to the beneficiary's cause, but courts will neither necessarily enforce all of those terms to the full extent of the parties' agreement, nor should they.

C. The Limits of the Law—The Duty of Loyalty

Enforcing the duty of loyalty provides another example of the gap between contracting parties' expectations and the degree to which those terms can be enforced. While courts sitting in fiduciary cases may be moralistic about how high the standard of a fiduciary's behavior could be, or even is, such flowery descriptions of affirmative devotion are not the basis of liability.[132] They are mere suggestions of what best practices might be.[133] Liability for breach of the duty of loyalty is limited to liability for indulging interests that conflict with a fiduciary's. Scholars on both sides of the fiduciary debate widely accept this point.[134]

Some scholars may disagree with that characterization and try to extend the meaning of loyalty as enforced by the law to the common understanding of social "loyalty." They point to the Delaware Supreme Court's recent expansion of the duty of loyalty in corporate cases to include an obligation to act in good faith as evidence that the duty of loyalty has expanded beyond a duty not to be conflicted without permission.[135] As will be discussed below, this line of cases reveals the struggle between dicta and liability, but it does not resolve it.[136]

The duty of good faith in corporate law is a catch-all category of obligations that directors owe, which encompasses elements of the duty of loyalty and the duty of care. It is impossible to name a breach of the duty to act in good faith that would not also be a breach of the duty of care (a standard of gross negligence applied to the procedures of decision making and paying due attention to the firm), a breach of the duty of loyalty (a duty to refrain from self-dealing), a breach of the contractual duty of good faith and fair dealing (requiring honesty in fact and prohibiting many kinds of opportunistic behavior),

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132. Johnson, *supra* note 112 , at 33–37 (quoting many examples of dicta regarding loyalty).

133. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 697–98, 745 (Del. Ch. 2005).

134. DeMott, *supra* note 43, at 926 ("[T]he fiduciary duty of loyalty proscribes self-dealing by the actor and other forms of self-advantaging conduct without the beneficiary's consent."); Easterbrook & Fischel, *supra* note 1, at 433 (recognizing that in investment advisor/client relationships, the duty of loyalty is limited to avoiding conflicted transactions); Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1210 (describing the duty of loyalty as performing in the entrustor's interest and not in conflict of interest); Ribstein, *supra* note 14, at 904 (arguing that the default fiduciary duty should prohibit all conflicts of interest).

135. Gold, *supra* note 50, at 464–66 (describing the emergence of the duty of good faith as an extension of liability where directors could be held liable even in the absence of a material conflict of interest); Johnson, *supra* note 112, at 34–35.

136. *Infra* Part V.B.

or a crime. The Delaware Supreme Court's use of moral rhetoric to admonish corporate directors may indeed serve an expressive function of setting norms for best practices and ways in which those directors ought to behave.[137] In recent years, the duty to act in good faith has been the object of dicta about how directors should behave. Indeed, the Delaware Supreme Court has stated that bad faith actions by corporate directors constitute breaches of the duty of loyalty.[138]

Of course, actions taken in bad faith were already prohibited and could lead to liability.[139] The shift does no more than classify a host of other behaviors that are already prohibited for other reasons as loyalty violations. For this reason, classifying bad faith as a violation of the duty of loyalty is merely a semantic change. Beyond ensuring continuing liability for breaches of fiduciary duty, even particularly egregious violations that originate from breaches of the duty of care, it is not clear that changing the classification of actions taken in bad faith from existing in a stand-alone category of liability to being part of the duty of loyalty makes much of a difference at all.

There is also a limit to what "bad faith" as a basis of liability adds to an understanding of actionable behavior. Even the corporate directors' obligation to act in good faith does not require devotion. It simply requires that directors not intentionally fail to perform known duties, not lie to shareholders, not willfully act to undermine shareholder interests, and not commit crimes.[140] Directors would not be allowed to do any of those things anyway. Many directors are not subject to personal monetary liability for breaching the duty of care, but intentional dereliction of duty would both violate the standard of care and constitute bad faith, which cannot be exempted from liability.[141] Calling particularly egregious breaches of care bad faith simply brings them back into the realm of monetary liability because the behavior goes beyond a mere breach of the duty of care. Intentionally acting to undermine the corporation's business and lying would also violate the implied covenant of good faith and fair dealing in every contract. Crimes are obviously punishable without calling them fiduciary breaches.

The fact that these behaviors are prohibited even without the application of fiduciary duty does not mean that they do not violate fiduciary obligations. But if we are trying to isolate what work the duty of loyalty does to add something that is not already there to a particular contractual relationship, to make that relationship different from others, then these good faith requirements do not do that. They do not add anything that differentiates a fiduciary relationship from any other contract to which a standard of care applies. It is the duty of loyalty that is uniquely fiduciary and the duty of loyalty uniquely prohibits unauthorized self-dealing. Telling us everything a fiduciary cannot do does not tell us what fiduciary duties are and it cannot be true that everything a fiduciary cannot legally do

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137. Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1696 (2001).

138. Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

139. Section 102(b)(7) of the Delaware Corporate Code allows corporations to exculpate directors from personal monetary liability for breaches of the duty of care. DEL. CODE ANN. tit. 8, § 102(b)(7) (2013). Directors may not be exculpated from personal monetary liability for actions not taken in good faith. *Id.*

140. Gold, *supra* note 50, at 473–81 (discussing how a director's intentional failure to perform duties violates the good faith requirement); *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del. Ch. 1996) ("[a] sustained or systematic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability."); Hill & O'Hara, *supra* note 50, at 1779–88.

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

(everything a person cannot legally do) is a breach of the duty of loyalty. That interpretation would render the duty of loyalty meaningless.

The duty of loyalty as a prohibition of self-dealing does not meet an expectation of devotion. It does not even meet a standard that would require the fiduciary to work tirelessly or enthusiastically to promote a beneficiary's interest. To the extent a beneficiary expects devotion from the fiduciary, or anything beyond good faith and fair dealing plus a duty of loyalty that prohibits self-dealing, there is a large gap between her expectations and the standard of behavior the law will enforce with liability against the fiduciary.

The hypothetical bargain creates, not fills, the fiduciary gap because the hypothetical bargain mode of gap filling requires us to divine the parties' expectations. To determine the hypothetical bargain, we must reach a conclusion about what the parties would have agreed given their requirements and expectations of the relationship. The fiduciary gap reveals non-optimal trust because it shows that the beneficiary had higher expectations of her fiduciary than the law would support by enforcing fiduciary duties. Indeed, the beneficiary likely made a decision to be vulnerable to the fiduciary's discretion and made a judgment based on the high expectations she had of the fiduciary's behavior and the extent to which she thought she would be protected from the consequences of the fiduciary's underperformance. Focusing on the beneficiary's expectations when using a hypothetical bargain to resolve a dispute reveals the gap between those expectations and the limits of the law.

D. Modeling the Fiduciary Gap

The interaction between the parties' expectations of a possibly fiduciary relationship and the way the courts interpret and enforce those agreements reveals a gap in the enforcement of the parties' expectations that the law cannot fill. The gap fillers are incomplete. To the extent vulnerable parties have high expectations, the law will disappoint them by only enforcing a basic duty of loyalty that is, only prohibiting fiduciaries from engaging in conflicted behavior or transactions without permission. This level of enforcement, supported by an often-weak duty of care will disappoint high expectations. Of course, one way to discourage non-optimal trust is to refuse to impose liability to vindicate it, but it is important to be honest about the fact that that is what courts are doing. Using moralistic rhetoric while refusing to extend liability may encourage non-optimal trust and mislead vulnerable parties about what they can reasonably expect from their fiduciaries, or at least mislead them as to what duties they can enforce.

1. Fiduciary Expectations and the Application of the Duty of Loyalty

To understand the fiduciary gap, consider the model in Table 1. Some beneficiaries have high expectations of the standard of behavior their fiduciaries will meet and be held to, while others have relatively low expectations that their fiduciaries will not do things proscribed by law, or breach applicable fiduciary duties. An element of correctly calibrating expectations, so as to suffer the minimum degree of disappointment or injury, is properly understanding the behaviors the law affects and how the law may influence those behaviors.

Table 1. Fiduciary Expectations and the Application of the Duty of Loyalty.

Parties' Agreement

	High Expectations		Low Expectations	
	No Explicit Fiduciary Duties[142]	Explicit Fiduciary Duties	No Explicit Fiduciary Duties	Explicit Fiduciary Duties
Duty of Loyalty[143]	Trusting Party: Gap Trusted Party: Type I Error or Correct (depends on expectations)	Correct	Type I Error	Correct
No Duty of Loyalty	Trusting Party: Type II Error Trusted Party: Correct Good faith applies	Type II Error	Correct	Type II Error

When a trusting party enlists another to do something for her or on her behalf, that party either has high or low expectations about the duties of loyalty and care that will apply. In each situation, the parties have either explicitly agreed that fiduciary duties will fill the gaps in their relationship and govern the entrusted party's behavior, or they have not so agreed.

Half of the model is fairly self-explanatory. Where the parties explicitly provide for a fiduciary relationship, they agree that a duty of loyalty will apply. A court enforces the correct duty when it enforces a duty of loyalty, and makes a Type II error (false negative) when it does not enforce a duty of loyalty. The interaction between the court's ruling and the parties' expectations becomes more complicated, of course, when the parties do not provide for fiduciary duties explicitly.

When the parties do not agree about the application of fiduciary duties and the trusting party has low expectations about how the trusted party will fulfill its obligations under the

142. Table 2 more thoroughly explores the circumstances this column of the model covers.

143. The duty of loyalty applied here is a requirement that the fiduciary not engage in conflicted interests without the beneficiary's permission.

agreement, it is unlikely that it will expect a duty of loyalty to apply. Recall that low expectations are calibrated to the particular incentives or consequences that encourage performance. When the parties have not explicitly agreed to have a fiduciary relationship or to use fiduciary duties as their gap fillers—either by choosing a traditionally fiduciary relationship or separately deciding that fiduciary duties will apply—then a trusting party with low expectations would not properly expect fiduciary duties to protect them. Safely having low expectations depends upon knowing what parameters will influence the behavior of the other party in the relationship. Assuming fiduciary duties will apply when they have not been specifically agreed upon would be careless and would indicate over-trust under the circumstances. Indeed, where there are no explicit fiduciary duties, and the parties have not arranged themselves in a kind of relationship that is traditionally considered fiduciary, it may be impossible to determine which party is the trusting party and which is the trusted party until one of them is disappointed. In such situations, both parties may trust the other to perform and be trusted to perform. The equality of position and duty would further indicate that the relationship should not be considered fiduciary. For those reasons, if a court applies a duty of loyalty where the trusting party had low expectations, that decision is most likely a Type I error, and a decision that the duty of loyalty does not apply would be correct.

But where one party has high expectations she almost always expects a duty of loyalty to apply. If a trusting party retains a trusted party to do something on her behalf, and the trusting party expects devotion, then the trusting party supposes that the trusted party will not engage in self-dealing unless the potential for entertaining conflicted interests is made clear from the outset. The duty of loyalty is a lesser-included element of high expectations in trusting relationships. In situations where the trusting party has high expectations and where there are no explicit fiduciary duties, the trusting party may be disappointed in the event of a problem even if the court applies a duty of loyalty to resolve the conflict. If a court applies the duty of loyalty, it may fall short of the trusting party's expectations if the trusting party was expecting something akin to devotion, a high level of competence, or to be able to punish the trusted party if the trusting party suffers a significant loss—even if the trusted party did not profit from the trusting party's loss. The duty of loyalty may not provide liability for all of the ways the trusting party's expectations could be frustrated, nor should it.[144] This leaves a gap between how the beneficiary might have expected the contract to be enforced and how it was actually enforced. The fiduciary, on the other hand, not expecting fiduciary duties, will find a Type I error (false positive) where the court enforces a duty of loyalty, but a correct outcome where the court does not.

Where there are no explicit fiduciary duties, the misunderstanding can be corrected through disclosure of the duties that will apply or a more complete negotiation between the parties. Communication between the contracting parties about the nature of their relationship, or the standards of behavior they owe each other, would help to clarify the beneficiary's expectations. But so would a clearer signal from courts about the definition and scope of an enforceable duty of loyalty.

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144. DeMott, *supra* note 43, at 926 (arguing that the fiduciary duty of loyalty does not demand an "all-encompassing subordination of the [fiduciary's] interests to those of the beneficiary's"); Frankel, *Fiduciary Duties as Default Rules*, *supra* note 11, at 1226–30 ("Fiduciaries are required to identify with the interests of entrustors *only to the extent that the fiduciaries exercise dominion over the entrustors or their property*, and to a lesser extent, with respect to the quality of their services . . . . [E]ven if they do give up something, they give up little.").

2. Enforceable Expectations with High Expectations and No Explicit Fiduciary Duties

The portion of the model where the trusting party has high expectations contains the most complex interactions between the parties' expectations and a court's possible response to problems that arise in their relationship. There, the trusting party might expect devotion, only a duty of loyalty prohibiting self-dealing, or a very specific kind of careful, meticulous performance. Without proper communication between the parties, it may be difficult to discern what the justifiable expectations are. Depending on the story the trusting party can tell about the negotiations, a court may (or may not) apply a duty of loyalty, or may find some other way to impose liability on the breaching trusted party. Focusing for now on how courts could respond to various sets of expectations of the parties (and the reasons for those expectations) using only a duty of loyalty or not, the next model in Table 2 considers the possibilities when the trusting party has high expectations. Table 2 is an expansion of Column 1 of Table 1.

Table 2. Fiduciary Expectations with High Expectations and No Explicit Fiduciary Duties.

Parties' Expectations

	Both parties think DOL	Trusting Party thinks Devotion, Trusted Party thinks DOL	Both parties think Devotion	Trusted Party lies to induce Trusting Party to think Devotion, but Trusted Party thinks no DOL	Trusting Party thinks Devotion or DOL, Trusted Party thinks no DOL through no fault of Trusted Party
Court decides Duty of Loyalty	Correct	Correct, but GAP	Correct, but GAP	Correct	May be correct. Fact specific decision
No Court decides No Duty of Loyalty	Type II Error	Type II Error	Type II Error	Type II Error, but implied covenant of good faith ("honesty in fact") or finding of fraud may force DOL outcome	May be correct. Fact-specific decision.

In Table 2, the trusting party expects the trusted party to perform at least as agreed, without engaging in conflicted interests, and perhaps with a particular enthusiasm for the trusting party's best interests. Where the parties both agree about the standard of conduct governing their relationship, the outcomes are easy—whether they both expect a duty of loyalty or both expect devotion, a court applying a duty of loyalty will be legally correct.

If one or both parties justifiably expect devotion, a duty of loyalty will fall short of that expectation. This reveals a gap between expectations and what the law is willing to enforce. Where the parties think they are on that spectrum of expectation may differ and there are different possible reasons why their expectations could diverge.

a. Devotion/Duty of Loyalty

For example, the trusting party may think the trusted party will be devoted to her cause where the trusted party thinks only a duty of loyalty will apply. The confusion arises simply because of the trusting party's high expectations. The trusting party believes that the trusted party will do her absolute best to enthusiastically advance the trusting party's best interests. Taking on a fiduciary task and being worthy of the degree of trust that high expectations generate demands that the fiduciary do her best to perform completely, at least in part, because of a personal drive to be trustworthy in sensitive matters. Even without making devotion part of the parties' explicit agreement, the trusted party may try to convince the trusting party that she is a trustworthy person.

Advertising a high degree of trustworthiness may be a way to generate business, and trusting parties may well rely on those assurances. Such assurances may not rise to the level of fraud, indeed, they are likely considered puffery. However, given the circumstances, promises of that nature may have the effect of inducing expectations that the fiduciary will act with something akin to devotion, particularly where the parties have agreed that a duty of loyalty will apply. Where the trusting party thinks the trusted party will be devoted to her interests, but the trusted party thinks only a duty of loyalty applies, a court will be technically correct to apply a duty of loyalty; however, that may disappoint the trusting party's expectations and it would be incorrect to refuse to apply a duty of loyalty, even where the parties have not explicitly agreed to have a fiduciary relationship. Failing to enforce a duty of loyalty would fail to honor both parties' expectations about how their agreement would be enforced.

The space between the devotion the trusting party expects and the duty of loyalty courts enforce is the most common fiduciary gap and the one the law cannot fill. It exists whether or not the trusted party thinks devotion or a duty of loyalty or no duty should apply. It is caused by many factors: rhetoric in fiduciary opinions; an impression among consumers in the marketplace; and legal scholars that argue that fiduciary duties require morally exemplary behavior. Although abiding by a moral obligation to be trustworthy and to do your best solely for the benefit of another may be good for business, that is not an obligation the law can or should enforce.

Meinhard v. Salmon is perhaps the most striking example of the disconnect between moralistic rhetoric and the duties courts will enforce.[145] Two joint venturers, Meinhard and Salmon, agreed to exploit a 20-year lease together.[146] Meinhard contributed money and Salmon managed the leased property, and the two shared the profits of the venture.[147] When the lease term was nearing its end, the owner of the property approached Salmon to ask if he would be interested in leasing the property covered by the original lease as well as adjacent property for another, longer term.[148] Salmon took the opportunity without

145. Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).
146. *Id.* at 546.
147. *Id.*
148. *Id.* at 551.

telling Meinhard.[149] When Meinhard discovered he had been shut out of the new lease, he sued.[150] Cardozo found a fiduciary relationship even though Meinhard and Salmon had not explicitly created a traditional fiduciary relationship and had not explicitly agreed fiduciary duties would apply. As noted above, the language in the opinion is deeply moralistic, purporting to require fiduciaries to renounce "thought of self."[151] In this case, the court found that the two parties were fiduciaries of each other, and owed each other "the duty of the finest loyalty."[152] Cardozo went so far as to borrow the words associated with marriage vows to describe the litigants as having been invested in their venture "jointly, for better or for worse."[153]

Despite all of these and other protestations that the courts should hold fiduciaries to very high moral standards and that fiduciaries should act only for the benefit of the beneficiary of their duties, the court seemed only to require Salmon disclose the opportunity to Meinhard, to give him a chance to compete for the new lease.[154] One might wonder how two parties bound to act only for each other could, in the end, only be required to set each other up to compete with the other. How could two parties, "in it for better or for worse," only have to tell each other that they ought to do their best to defeat the other? Cardozo notes that Salmon had a heightened obligation to consider Meinhard because of his position as managing co-adventurer; for Salmon, "the rule of undivided loyalty [was] relentless and supreme."[155] Salmon would be the first, if not only, party to hear of opportunities brought to the venture, so it was incumbent upon him not to take advantage of that position for personal gain to the exclusion of Meinhard.[156] That is the standard duty of loyalty that even the most unromantic courts apply. A requirement of complete devotion might have led to other duties, such as to give Meinhard a right of first refusal, or a right to join in the new venture on the same terms as the last; but the court only applied a duty of loyalty—a rule that prohibited Salmon from being conflicted without permission.[157]

Similarly, in another famous case, *Page v. Page*, the court held that in a partnership between two brothers, bound by fiduciary ties, only a basic duty of loyalty applied, not devotion.[158] One Page brother, the defendant, had more money than the other, the plaintiff.[159] When the business that had yet to turn a profit looked like it might finally enjoy some success, the defendant decided to dissolve the partnership and buy the business for himself, without his brother's participation.[160] In *Page*, there is an argument that a greater duty than in *Meinhard* could be owed. The two brothers were engaged in a formal partnership and one partner was ending that partnership for the explicit purpose of taking

149. *Id.*
150. *Meinhard*, 164 N.E. at 546.
151. *Id.* at 548.
152. *Id.* at 546.
153. *Id.*
154. *Id.* at 547.
155. *Meinhard*, 164 N.E. at 548.
156. *Id.*
157. The remedy in *Meinhard* was a disgorgement remedy, as is standard in cases of fiduciary breach. Because Salmon breached his fiduciary duty to disclose the opportunity to Meinhard, he must disgorge his gain, meaning that he was required to give Meinhard a nearly 50% interest in the new venture—because that represents the value of the advantage Salmon took to the exclusion of Meinhard. *Id.*
158. Page v. Page, 359 P.2d 41 (Cal. 1961).
159. *Id.*
160. *Id.* at 44.

the benefits of the business for himself, to the exclusion of his brother.[161] The plaintiff tried to prevent the dissolution of the partnership because he wanted to be able to enjoy the profits of the business just as he had to endure its losses.[162] He could not. He was entitled only to a fair accounting for his share of the partnership.[163] Of course, because the partnership was a going concern, the partnership's value included the present discounted value of future expected profit. The value of those future prospects was evident at the time of dissolution and part of what both brothers owned together, so it stands to reason that one brother could not take that from the other without paying for it.[164] But the court did not require devotion. It did not require the wealthier brother to share the business against his will. Thought of self was honored, as long as it was bought and paid-for.

In both cases, the plaintiff's position seemed to assume a higher standard of loyalty than was applied. In both cases, the defendants may have reasonably expected some duty of loyalty would apply—Page, because he and his brother formed a partnership and Salmon, because he was trusted to do something for Meinhard and on behalf of their joint venture. Still, upon finding many avenues for an expectation of devotion, the courts applied a more limited duty of loyalty.

I chose these cases to demonstrate the point here because they are the classic, canonical cases one turns to time and again to understand and explain fiduciary obligation. *Meinhard* contains classic statements that scholars on both sides of the fiduciary debate use to explain the meaning of fiduciary obligation. It is possible to find cases from different corners of the country reaching a variety of conclusions,[165] but these classic cases are among the most influential. They have formed the basis of fiduciary understanding for generations of lawyers, judges, and academics. And, they demonstrate that even in circumstances screaming for a standard of devotion, courts will only apply a duty of loyalty, a duty against self-dealing. Part V of this Article argues that this limited understanding of the duty of loyalty is necessary and appropriate. For now, let us continue to explore the fiduciary gap between the parties' expectations and the terms courts will enforce.

b. Devotion/No Duty of Loyalty Because Trusted Party Lies

Even if the trusted party goes so far in trying to raise the trusting party's expectations and trust that she convinces the trusting party to expect devotion through misrepresentations about how she will behave, the application of the duty of loyalty is still the correct resolution according to extant fiduciary doctrine. This situation is slightly different from the last, where the trusted party might have made representations to encourage high expectations without specifically lying in order to do so. Where the trusting party has been misled, the law will still not enforce more than a traditionally defined duty of loyalty. The mistrusted fiduciary will be accountable to the beneficiary for profits resulting from the breach or for damages for harm caused.

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161. *Id.*
162. *Id.*
163. *Page*, 359 P.2d at 44.
164. *Id.*
165. *See, e.g.*, Easterbrook & Fischel, *supra* note 1, at 440 (stating that "[i]t is possible to repeat this demonstration for many cases").

When the trusted party lies to induce the trusting party to enter the relationship based on the belief that the trusted party will act with devotion or loyalty to pursue the trusting party's best interests, the correct result is to apply a duty of loyalty; this is true even when the trusted party thinks that a duty of loyalty will not apply, and even where the trusting party should not have assumed that a duty of loyalty would apply. That outcome honors the parties' revealed expectations. If the trusted party had not been dishonest, the trusting party may never have entered the relationship. There is no way to know if there would be a relationship at all if the trusted party's devotion had not been a term. Therefore, the duty of loyalty must be the term the court enforces as the most likely result of the parties' bargaining.[166] The application of the duty of loyalty in these cases is an example of the contractarian approach, not a challenge to it.

An example cited above illustrates this point. Recall that in *Chou v. University of Chicago*,[167] a professor promised a graduate student that, although the University would own her patents, he would be sure to properly credit her for her work in the patent applications.[168] The professor then credited himself and others, not Chou, for her work, directly failing to honor his promise to her. The University and the professor were Chou's employer and supervisor, respectively. They were not necessarily her fiduciaries. If anything, she was theirs. But the professor promised to guard Chou's personal interests, even if it meant sharing his own monetary rewards for the patents with her. That promise became a term of their agreement. It is not clear that Chou would have agreed to work in the professor's lab without that term in place. The court allowed Chou's claim for breach of fiduciary duty against the University to stand, noting that the professor was in a position of authority and that Chou had trusted him to fill out the patent applications as promised.[169] The court went further and also allowed claims for breach of contract against the University because it would have been unjust to allow it to keep all of the royalties from the joint inventions.[170]

This application of fiduciary obligation confirms, rather than undermines, the contractarian view. The court simply enforced the terms of the parties' negotiation. Indeed, in this agreement, there was no gap. The parties specified how Chou would be credited for her work, and the court simply enforced the agreed-upon term. The fact that that term happened to parallel the duty of loyalty in that event does not change the fact that it was a mutually agreed- and relied-upon term. The court did find that the professor owed a fiduciary duty because his position of superiority led Chou trust him. While this might seem to be a statement that would support a characterization of the relationship as fiduciary because of the unequal position of the parties and Chou's relative vulnerability, the court talks about the trusting party "justifiably placing trust in another so that the latter gains superiority and influence over the former."[171] That is a statement about the justifiable expectations that lead the trusting party to enter the relationship. Chou worked at the lab and made herself vulnerable because the professor induced her to trust: it was therefore treated as a term in their agreement. A correct conclusion in these situations is to apply at

166. This is true even if the trusting party expected devotion because, as explained above, the law does not enforce devotion.

167. Chou v. Univ. of Chi., 254 F.3d 1347 (Fed. Cir. 2001).

168. *Id.* at 1361.

169. *Id.* at 1362–63.

170. *Id.* at 1363–64.

171. *Id*. at 1362.

least a duty of loyalty where the term is responsible for drawing the trusting party into the relationship in the first place.

Indeed, fiduciary obligation as a body of law may not have been necessary to reach the decision in *Chou*. One could argue there was no gap to fill: the professor promised to do "x" (credit Chou on the patent application) and did not. If there was a gap in the parties' agreement between the formal agreement with the University and the less formal agreement between Chou and her professor, a lesser gap-filler may do the job. Where the trusted party has not been "honest in fact," the implied covenant of good faith may lead to the same outcome the duty of loyalty would require, even where fiduciary duties do not apply. In *Chou*, the covenant of good faith and fair dealing may have required the enforcement of the professor's misleading promise. The same may be true where the trusted party has made a material misrepresentation of fact such that it could be liable for fraud. That is, where the trusted party promises to perform in a certain manner or induces the trusting party's participation in the relationship by promising to perform in a certain manner or by representing that he is on the trusting party's side and working for the trusting party's benefit, then courts may enforce that promise even in relationships where fiduciary duties would not traditionally apply.

The Goldman Sachs scandal involving ABACUS investments is an example of this part of the model. The parties settled the case, and so the court did not go to a decision on the merits,[172] but the settlement the parties reached can be seen as an expression of what the parties may have agreed had they bargained about the issue from the outset, as the settlement is effectively the result of a bargain between the parties. Goldman Sachs sold collateralized debt obligations backed by particularly risky subprime mortgages—known as ABACUS 2007-AC1 (the "ABACUS securities")—to investors.[173] At the same time, Goldman designed a package of investments whose success depended on the failure of the ABACUS securities. It appeared after the fact as though Goldman stood to make more from the failure of the ABACUS securities than from their success, thereby selling investments to investors that seemed well-designed to make money for Goldman executives to the detriment of the investors to whom Goldman had marketed and sold them. Goldman settled for an unprecedented $550 million and its admission that it should have disclosed the fact that someone whose financial interests was opposed to the ABACUS securities was involved in designing them.[174] There was no finding of a breach of fiduciary duty, and, although the litigation was based on a fraud claim, investors clearly over-trusted Goldman Sachs and the settlement reached a resolution very similar to what the enforcement of a duty of loyalty would have looked like.[175]

172. Press Release, Securities Exchange Commission, Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO (July 15, 2010), *available at* http://www.sec.gov/news/press/2010/2010-123.htm.

173. *Id.*

174. *Id.*

175. *See* Larry Ribstein, *The SEC's Strike Suit*, TRUTH ON THE MARKET (July 18, 2010), http://truthonthemarket.com/2010/07/18/the-sec's-strike-suit/ (explaining the unclear extent of Wall Street investment firms' fiduciary duty towards investors).

c. Devotion or Duty of Loyalty/No Duty of Loyalty—No Fault

In cases where the trusting party expects devotion or loyalty on the part of the trusted party, but the trusted party, through no fault of its own, thinks it owes no such duty, the parties have either failed to communicate or there really is a question about what expectations the circumstances justify. Even when it is clear that fiduciary duties will fill gaps in the contract, it might not be clear whether there is a gap in a particular circumstance. These are the cases in which an ad hoc determination is appropriate, and reasonable minds could differ as to whether a fiduciary duty applies. These are the difficult cases. It is impossible to know what terms the parties would have agreed to in a particular circumstance if their justifiable expectations about the terms they negotiated are different. Contrary to what notions of fiduciary obligation might teach us, the trusting party does not always win in the event of this kind of confusion. Two well-known cases reach opposite conclusions on similar facts where the parties' expectations diverged about whether there was a gap and what duties would apply in the event of a gap.

In *Jordan v. Duff & Phelps*,[176] the court held that fiduciary duties applied in favor of Jordan, an employee who owned shares in Duff & Phelps, a closely held corporation, as part of his employment with the firm. The shareholding agreement between the parties provided that if Jordan's employment with the corporation terminated "for any reason, including resignation, discharge, death, disability or retirement," Jordan should sell his shares back to Duff & Phelps at their book value as of the prior December 31.[177] The firm was engaged in merger negotiations with a potential acquirer when Jordan resigned to take another job. Instead of disclosing the possibility of merger to Jordan, Hansen, the chairman of the board, simply recommended that Jordan stay on until the end of the year (only about a month) to receive the book value of his shares as of that year's end.[178] When news broke that Security Pacific was to acquire Duff & Phelps for $50 million, Jordan did not cash the check he had received for his shares and instead filed suit alleging that Duff & Phelps breached a fiduciary duty to him by repurchasing his shares without disclosing the possibility of the acquisition.[179] This breach, Jordan argued, amounted to insider trading under the state law special circumstances rule because the corporation purchased shares from him in a face-to-face transaction without disclosing known information that would have a significant effect on the stock price.[180]

The court held in Jordan's favor, ruling that Duff & Phelps breached a duty to Jordan by failing to disclose that a merger was on the horizon.[181] It found a gap in the shareholding agreement about whether Duff & Phelps would have to tell Jordan material information that might inform his decision about whether to sell his stock at all, or in this case, whether to resign his position.[182] In the event of such a gap, the fiduciary duties the corporation

176. Jordan v. Duff & Phelps, 815 F.2d 429 (7th Cir. 1987).

177. *Id.* at 432.

178. *Id.*

179. *Id.* at 433.

180. *Id.* at 435 ("The 'special facts' doctrine developed by several courts at the turn of the century is based on the principle that insiders in closely held firms may not buy stock from outsiders in person-to-person transactions without informing them of new events that substantially affect the value of the stock.").

181. *Jordan*, 815 F.2d at 436.

182. *Id.* at 435.

owed to its shareholder applied by requiring the disclosure of the information about the planned sale of the company for Duff & Phelps to avoid self-dealing.[183]

In his dissent, Judge Posner argued that no gap existed in the contract.[184] Because Jordan's employment was at-will, the dissent argued that Duff & Phelps could have fired him at any time for any reason.[185] Therefore, Jordan would not have been able to make a decision about whether to sell his stock based on information about the sale of Duff & Phelps;[186] the information would have been useless to Jordan. Judge Easterbrook, writing for the majority, disagreed with Posner about whether Jordan had any right to make a decision about his shareholding at all, let alone whether he could make one after announcing his resignation.[187]

Reasonable minds clearly differed about whether there was a gap, what the gap was, and whether fiduciary duties should fill it. Duff & Phelps may well have acted in good faith assuming the shareholding agreement completely provided for its obligations in the event an employee's resignation, and Jordan honestly seemed to believe the firm should have disclosed its future plans to him when purchasing his stock. The justifiable expectations of the parties honestly differed. Maybe Jordan would not have taken the job if he had known that Duff & Phelps could repurchase his shares from him without disclosing plans for a lucrative merger in the near future. Still, a more convincing argument may be that Duff & Phelps would not have allowed their employees to own stock if they knew that they would have to allow those employees to base decisions about whether to stay with the firm on the value of that stock, thereby allowing disloyal employees to stay just to earn profits from a merger. Perhaps there was no gap and the shareholding agreement completely defined what would happen with Jordan's stock if he resigned, which he, arguably, did of his own accord.

On somewhat similar facts, the court in *Ingle v. Glamore Motor Sales, Inc.*[188] found that a shareholder–employee in a closely held corporation did not acquire a right against at-will termination by reason of his shareholding. In that case, Ingle had worked for Glamore, the sole shareholder, for a number of years.[189] His shareholding agreement with Glamore stated that Glamore would have the "right to repurchase all of Ingle's stock if 'Ingle shall cease to be an employee of the Corporation for *any reason*.'"[190] The court found there was no gap in the agreement, so when Glamore fired Ingle without cause, Ingle's status as a shareholder did not require the imposition of fiduciary duties.[191] Even though the corporation may owe its shareholders fiduciary duties under some circumstances, those duties only serve to fill gaps.[192] There was neither a gap as to whether Ingle could be fired without cause (he could), nor as to whether Ingle had to resell his shares to Glamore if Glamore terminated his employment for any reason or no reason (he

183. *Id.*
184. *Id.* at 444.
185. *Id.* at 449.
186. *Jordan*, 815 F.2d at 449.
187. *Id.* at 437–38.
188. Ingle v. Glamore Motor Sales, Inc., 535 N.E.2d 1311 (N.Y. 1989).
189. *Id.* at 1312.
190. *Id.*
191. *Id.* at 1313.
192. *Id.*

must).[193] Accordingly, fiduciary duties would not intervene to save Ingle from either fate.[194]

From Ingle's perspective, it is not difficult to believe that he trusted that Glamore would not fire him without cause after years of faithful service in a position of significant responsibility with the firm. Even if he realized that the agreement provided that he could be fired at-will, for any or no reason, he may have grown to (non-optimally) trust in Glamore to treat him better than that. If Ingle had maintained lower expectations and simply trusted that Glamore would abide by the agreement, he would not have over-trusted and he would not have been surprised by the termination of his employment. Indeed, the dissent points out that Glamore fired Ingle for the express purposes of re-purchasing his shares and replacing Ingle with his two sons.[195] Glamore's behavior seems more self-serving and even more opportunistic than that of Duff & Phelps, and Glamore was accused of mistreating an employee who had worked at the firm as a high level manager, officer, and director for decades and who had, at times, advanced personal funds to the business to allow it to continue to operate. Surely, Ingle's high expectations were more justified than Jordan's. Still, the court reached the exact opposite conclusion, ruling against the more vulnerable trusting party.

One could reconcile *Jordan* and *Ingle* on the basis that *Jordan* involved a voluntary decision to sell stock back to the corporation, and close corporations are specifically required by law to disclose material information about the stock in face-to-face transactions.[196] Still, Easterbrook and Posner argued at length about whether Duff & Phelps would have been able to do exactly what Glamore did. It is unclear whether the agreements themselves or the parties' intentions differed at all. Still, courts reached diametrically opposed conclusions about the applicability of fiduciary duties to employees' shareholdings in close corporations.

The models described in this Part demonstrate the gap that can exist between some trusting parties' justifiable expectations and what duties courts are willing to enforce. They show how high expectations can result in over-trust that fiduciary liability cannot correct. The law of fiduciary obligation does not seem to diverge from enforcing a hypothetical bargain defined by the parties' justifiable expectations, except to the extent that it will not enforce even a justifiable expectation of devotion. The models also demonstrate the good and bad ways courts may respond to parties' expectations in various circumstances, showing that courts may enforce the duty of loyalty when the trusted party has been dishonest, even if fiduciary duties would not have otherwise applied. Finally, the models do not provide an answer for every circumstance. Courts seem divided and make unpredictable ad hoc determinations where the parties cannot agree on where the gaps in their contracts are, or on whether fiduciary duties apply to fill those gaps. Where justifiable expectations diverge, there is no clear path.

193. *Ingle*, 535 N.E.2d at 1313.

194. *Id.*

195. *Id.* at 1316.

196. Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 435 (7th Cir. 1987) ("Close corporations buying their own stock, like knowledgeable insiders of closely held firms buying from outsiders, have a fiduciary duty to disclose material facts.").

V. WHY THE LAW SHOULD NOT FILL THE FIDUCIARY GAP

Recall that there are two questions to answer when confronted with a possible fiduciary relationship: (1) is there a fiduciary relationship? and (2) what duties does the fiduciary owe? The law does not completely answer either question, leaving inevitable gaps in the contracts of parties that enter into relationships that may be fiduciary in nature or at least lend themselves to the application of fiduciary obligation. Where parties have differing expectations about the gap fillers to use in the relationship or about where the gaps in their agreement are, the law cannot predictably answer the question of whether there is a fiduciary relationship. When parties differ as to their expectations about the level of care and commitment the trusted party should have in performing under the agreement, the law may not be able to fully enforce the justifiable expectations of a trusting party that over-trusts. Fiduciary duties alone cannot fill this gap in fiduciary relationships, and other legal mechanisms should not fill it either. This Part explains why the law cannot and should not fill such gaps before the final Part of the Article details other mechanisms parties can use to narrow the fiduciary gap.

A. Is There a Fiduciary Relationship?

As mentioned above, it is important to be able to apply fiduciary duties even where the parties do not explicitly agree that their relationship will be fiduciary.[197] Requiring parties to explicitly invoke fiduciary terms would allow sophisticated parties to take advantage of less sophisticated parties by simply neglecting to include fiduciary terms in their agreements.[198] That would undermine the goal of protecting vulnerable parties that is often a defining feature of a fiduciary relationship.[199] Courts often find fiduciary relationships by comparing cases without explicit fiduciary terms to relationships that are traditionally considered fiduciary.[200] If the circumstances and the positions and expectations of the parties are similar, then a court may find a fiduciary relationship by analogy, even where the parties did not realize in advance that a duty of loyalty would apply. It is important to carefully consider both parties' justifiable expectations in finding a fiduciary relationship.

Fiduciary duties should no more be imposed on unsuspecting parties than any other contract term to which they do not agree. Fiduciary duties are costly to enforce and deviate significantly from non-fiduciary contractual relationships. Many contracting parties would not engage in transactions that would prohibit them from pursuing self-interest or conflicting transactions. To completely alter that expectation would impose on one party something he did not and would never have agreed to. Unpredictably applying fiduciary duties may also harm beneficiaries. If trusted parties may be subject to fiduciary duties when they do not intend to be, they will charge more for their services, perhaps making them unaffordable for beneficiaries or refuse to provide a certain range of services at all.

As Table 2 demonstrates, even parties with very thorough written contracts may sometimes find unanticipated gaps in their contracts. When particular circumstances arise,

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197. *See supra* notes 30–31 and accompanying text (discussing the implied fiduciary duties that arise between parties to a contract).

198. Easterbrook & Fischel, *supra* note 1, at 431.

199. Ribstein, *supra* note 5, at 212.

200. Frankel, *Fiduciary Law*, *supra* note 11, at 821.

they may disagree about what the contract provides. One party might believe there is a gap that the chosen gap filler should fill, and the other party may believe the agreement completely determines how the conflict should be resolved. Those are common problems in contract interpretation. Fiduciary law makes them neither easier nor harder to resolve. Fiduciary duties as gap fillers do not solve the problem when two parties have reasonable grounds to disagree about whether there is a gap in their agreement at all. Courts must simply do their best to reach a sensible resolution in light of the available facts, and as we have seen, courts may well be as divided as the parties. Deferring always to the interests and expectations of the party that wants fiduciary duties to apply would be as harmful as always deferring to the trusted party.

Similarly, there may be a disagreement about whether fiduciary duties are the appropriate gap filler. Even where fiduciary duties apply to some aspects of an agreement, they may not apply to others. At some point in their relationship, the parties may think that they are able to plan for the future without regard to a fiduciary obligation they owe to a current business, as in *Meinhard* and *Page*.[201] Some scholars have pointed out that parties intentionally leave gaps in their contracts that they intend to fill with extralegal, not legal, mechanisms.[202] Fiduciary law may help us figure out when fiduciary duties should apply and what kinds of relationships ought to be fiduciary. But where the parties have not entered a traditionally fiduciary relationship or explicitly agreed to apply fiduciary duties, the determination of the nature of the gap filler to use will be a fact-specific inquiry that will depend on an understanding of the parties' expectations and the terms that drove their agreement.

B. What Duties Apply?

The fiduciary gap lies between some trusting parties' justifiable expectations and the maximum duty of loyalty courts will enforce because courts will not enforce an expectation of devotion with liability. Devotion means more than the duty of loyalty—it contemplates competence, hard work, and zeal in work done on behalf of a trusting party.[203] The duty of care fiduciaries owe does not extend that far. The admonition to renounce thought of self does not apply literally to the duty of loyalty, and it certainly does not extend to the duty of care, where completely selfless behavior in the service of another would be impossible.[204]

The gap between devotion and the duty of loyalty is driven by a duty of care that falls short of expectations of devotion, and even short of expectations of special care and attention. Part of that gap is necessary to afford fiduciaries the benefit of a business

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201. *See supra* Part IV.D.2.a. (discussing the factual details of *Meinhard v. Salmon* and *Page v. Page*, where one party made business plans outside of the prior business arrangement's fiduciary relationship).

202. *See* Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 192–93 (2009) (highlighting norms in complex business transactions); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1795 (1996) (explaining how parties to an agreement may forego memorializing terms in an agreement because doing so would entail costs that are "prohibitively high").

203. Gold, *supra* note 50, at 488.

204. Ribstein, *supra* note 14, at 909 ("The implied covenant of good faith and fair dealing . . . enables contracting parties to act selfishly as long as this conduct is at least broadly consistent with the parties' ex ante expectations based on the contract."); Ribstein, *supra* note 5, at 220 (arguing it would be impractical to require selflessness "regarding the fiduciary's commitment of time and attention").

judgment rule that provides the space and freedom from liability required to make business decisions, and even take business risks, with someone else's money and on someone else's behalf. This limitation benefits trusting parties by allowing the trusted party to take risks necessary to realize greater profits for the beneficiary.

The rest of the gap is required to avoid imposing an impossible-to-define-or-enforce standard on fiduciaries. It is impossible to describe exactly what complete devotion would look like, to find the best an individual can do and compare that to the best anyone can do, to determine a minimum level of expertise or competence required of a fiduciary after the relationship has begun. One fiduciary may be able to do a much better job with much less work than another, simply because of a different level of experience or talent. A duty of care is not what separates the two fiduciaries.

Beneficiaries may choose fiduciaries based on a variety of factors and must take them as they find them. To enlist the services of a fiduciary who has a particular degree of experience and talent and then to later hold that fiduciary liable for not being better than the beneficiary ever could have expected the fiduciary to be, is to honor unjustified expectations of the beneficiary and to undermine the important principle of honoring the agreement the parties made, rather than the agreement they wish they had made. The beneficiary agreed to pay a price based on the characteristics of the fiduciary she hired. She is not entitled to expect a higher value than that.

The gap between beneficiary expectations and the enforceable duty of care is particularly pronounced in Delaware corporate law. The difficulties with trying to use law to fill the gap are also particularly pronounced. Delaware Courts have tried to fill, or at least narrow, the gap with moralistic rhetoric, but have avoided going so far as to impose liability.[205] The struggle to define the standard of behavior up while defining the standard for liability down has confused shareholders responsible for enforcing corporate fiduciary duties and has widened the gap between expectations and liability. For example, shareholders often bring derivative suits against corporate directors alleging breaches of the duty of loyalty that are actually breaches of the duty of care.[206] The directors were not accused of self-dealing, they were alleged to be inattentive or incompetent at worst.[207] Delaware has a strong business judgment rule coupled with a statutory provision allowing corporations to opt out of personal monetary liability for directors who breach the duty of care.[208] The duty of care, only a gross negligence standard to begin with, poses only a minute risk of liability.

There are many good reasons the duty of care is such a low, rarely enforced, standard. One is that personal monetary liability for a major public corporation's breach of the duty of care would be devastating to individual directors and would drive director and officer

205. Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (holding that obligation to act in good faith was not on the same footing as duty of care).

206. Note that some scholars believe that breaches of the duty of care and the duty of loyalty should be framed as breaches of the duty of loyalty because both are failures to "actively pursue the best interests" of the beneficiary. Hill & McDonnell, *supra* note 70, at 1779.

207. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009); *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996); *AmSouth Bancorporation*, 911 A.2d 362.

208. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d at 124 ("8 Del. C. § 102(b)(7) [] exculpates directors from personal liability for violations of fiduciary duty, except for, among other things, breaches of the duty of loyalty or actions or omissions not in good faith."); "The 'business judgment rule' is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Id.*

insurance premiums to prohibitive heights. Capable directors would refuse to serve public companies for fear of frequent litigation leading to career-ending liability simply for getting difficult business decisions wrong or for failing to discover compliance failures or other misdeeds by officers or other employees in the company. Being a corporate director is a part-time job[209] and directors receive much of the information they use to perform their oversight obligation from the very corporate employees they are supposed to be monitoring.[210] Still, the law places ultimate responsibility for corporate decision making on directors' shoulders. Enforcing those obligations with enormous (potentially in the hundreds of millions of dollars in some instances)[211] personal liability against part-time workers would be ludicrous.

Delaware struggles with this gap in the fiduciary relationship between the directors and the corporation. While it is clear that personal monetary liability for breaches of the duty of care would be unrealistic, it is also nonsensical to call directors fiduciaries if they do not owe a meaningful duty of care.[212] In light of corporate scandals at the turn of this century, there was a sense that Delaware needed to do more to discipline directors without losing public company incorporations.[213] The Delaware Supreme Court responded by focusing on directors' obligation to act in good faith and stating that particularly egregious violations of the duty of care (reckless disregard for duties, failure to act in the face of a known duty to act) would qualify as bad faith for which personal monetary liability has always been available.[214] This served as a reminder that directors could still be held liable for personal monetary damages for breaching the obligation to act in good faith. The Delaware Supreme Court then went further in *Stone v. Ritter* to proclaim that such failures to act in good faith constituted breaches of the duty of loyalty.[215] This seemed to up the

209. KORN/FERRY INT'L, 33RD ANNUAL BOARD OF DIRECTORS STUDY 23 (2006), *available at* http://www.kornferryinstitute.com/sites/all/files//documents/briefings-magazine-download/33rd%20Annual%20Board%20of%20Directors%20Study%20.pdf (finding corporate directors spend an average of 17 hours per month on board responsibilities, including travel).

210. MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 204 (8th ed. 2000); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 872 (1991).

211. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 960–61 (Del. Ch. 1996) ("[P]ayments that Caremark has been required to make total approximately $250 million.").

212. Alces, *supra* note 43, at 245 ("While the duty of care is not uniquely fiduciary, it would be incongruous to conclude that a fiduciary should not be held to a meaningful standard of care.")

213. Managers decide where to incorporate firms when they go public. Many believe that so many corporate managers choose to incorporate in Delaware, in part, because of Delaware's relatively management-friendly corporate law. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 668–69 (1974).

214. The court made this point largely without imposing liability. In the *Disney* case, the Delaware Supreme Court went to some lengths to announce a standard for good faith that prohibited "reckless disregard" for one's duties and a failure "to act in the face of a known duty to act" while pointing out that some willfulness or maliciousness was required to elevate a breach of the duty of care to bad faith. *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2003). Still, the court did not impose liability against the Disney directors for bad faith. *Id.* The Delaware Supreme Court has also not held directors liable in other prominent cases defining bad faith, *Caremark* and *AmSouth Bancorporation*. *In re Caremark*, 698 A.2d 959; Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006).

215. *AmSouth Bancorporation*, 911 A.2d at 369–70.

ante in some ways and even succeeded in convincing some scholars that something had changed.[216]

There is no legal consequence, however, to changing the characterization of the obligation to act in good faith. Legal redress has always been available in corporate law for directors' bad faith, and bringing bad faith within the realm of the duty of loyalty does not change that. It does not even change the definition of bad faith. Despite all of the rhetoric and the reshuffling of the deck chairs, the Delaware Supreme Court has also made clear that personal monetary liability for directors' failures to act in good faith will be rarely enforced.[217] It remains the case that personal monetary liability for directors will not be the response to all, but only the most egregious breaches of the duty of care.

Delaware has tried to respond to the gap in accountability and shareholders' expectations, but takes a step back for every step forward. The goal seems to make liability for breaches of fiduciary duty in corporate law very predictable and not overwhelming. We simply do not want to make these points with liability. The gap between expectations and enforceable duties will remain. Other mechanisms will have to take the place of liability to make directors accountable for their actions.

The Delaware corporate law struggle with the duty of care is an example of the difficulty courts have in imposing liability for everything a fiduciary may do wrong or may do to frustrate the justifiable expectations of a beneficiary. Certainly, shareholders expect that directors will act with care, as well they should. But that expectation is not always one the law is willing to enforce because of the high costs (in litigation, liability, chilled corporate decision making, loss of the service of talented directors) imposed by enforcing a meaningful standard of care with liability. Indeed, concern about imposing excessive or unpredictable liability permeates fiduciary law.

C. Well-Defined Duties as Contract Terms

Fiduciary duties have long been regarded as standards.[218] The duty of loyalty, particularly, is billed as an amorphous standard of fiduciary behavior. It makes sense that gap fillers would be framed as standards. If it is impossible to describe all of the ways one could breach the contract, hence leaving a gap, then it is a standard we would use to judge future behavior, not a particular rule. Duties of care are also described as standards. There are many ways to not be careful enough. We evaluate behavior against a standard of care. Negligence, gross negligence, and recklessness are all matters of degree. Where behavior falls on that spectrum of carelessness is an ad hoc determination. The behavior must be held up to a standard and measured, however imprecisely, using our best judgment.

While they may be standards, fiduciary duties are growing more and more specific, constituting *specific*, not amorphous, standards.[219] Fiduciary duties are not unpredictable. There is significant guidance in how to interpret the relevant standards of behavior and we have specifically described many of the behaviors that would constitute breaches.[220] The

216. *See* Gold, *supra* note 50 (noting that Delaware courts have adopted a major change in their loyalty jurisprudence).

217. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009); *In re Caremark*, 698 A.2d at 967–70.

218. *See* Sitkoff, *supra* note 16, at 198 (noting that in all fiduciary relationships, the general duties of loyalty and care are typically phrased as standards).

219. *Id.*

220. *Id*. at 7.

professions have codes of ethics and responsibility that guide professionals' behavior toward the beneficiaries of their fiduciary duties.[221] Those codes list and explain various prohibited behaviors. Further, a rich common law has developed around common fiduciary relationships to explain what would constitute breaches of the duty of care in various circumstances and to define those breaches in more detail. Robert Sitkoff calls these bits of guidance "specific subsidiary fiduciary duties" that function more like rules.[222]

In particular, the duty of loyalty is quite specific. "Do not be conflicted without permission" is a direct command; it prohibits a particular kind of activity. Whether someone has engaged in a conflicted interest or earned a profit at the beneficiary's expense or exclusion, or in entertaining an interest contrary to that of the beneficiary, will be apparent. It is not a matter of degree. There is no continuum for self-dealing. In this way, the duty of loyalty can function as a rule. We cannot predict every set of circumstances that will lead to a breach, but whether a breach has occurred, that is, whether the fiduciary realized gain from a conflicted interest, will usually be readily apparent.

The reality of fiduciary enforcement reveals that fiduciary duties are narrower than we assume and more predictable: they do not stretch to reach all expectations or all hopes.[223] They do not mete out unpredictable justice from equitable principles. If we treat fiduciary duties like any other contract term, a chosen gap filler, then parties may have a better understanding of how they function and how to use them most effectively. As courts try to determine the parties' justifiable expectations, or the terms they would have agreed to from the outset, they are performing a kind of contract interpretation, trying to determine the meaning of an agreement that serves as the basis of a relationship. Fiduciary relationships do not pose more of a contract interpretation problem than any other agreement with big or important gaps.

As parties adopt fiduciary duties as a gap filler, they are simply importing a term and the body of law that goes with it. In that way, the decision is like a choice of law clause. One term brings an entire body of law into the enforcement of the agreement, and the parties choose it for themselves. Understanding fiduciary duties this way may encourage parties to make a decision about what their gap filler will be. Making a clear decision at the outset will prevent error costs. It will not necessarily close the gap this Article has identified because deciding whether the relationship is fiduciary is only the first step. Work remains to ensure that parties understand what the fiduciary designation means and what it does not mean. The last Part of this Article considers how to narrow the fiduciary gap without resorting to liability.

VI. NARROWING THE FIDUCIARY GAP

It would be impossible to close the fiduciary gap by enforcing higher standards with liability, so we should not try. There are other ways to close, or at least decrease, the size of the gap between parties' expectations and enforceable duties. These mechanisms do not rely on legal recourse or personal liability. Instead, they focus on how the parties can treat each other differently to better realize mutual outcomes. Law should get out of the way of these supra-legal mechanisms. The more the law tries to control the non-actionable

221. Examples of codes of ethics and responsibility include the ABA MODEL CODE OF PROFESSIONAL RESPONSIBILITY, the AMA CODE OF MEDICAL ETHICS, and the AICPA CODE OF PROFESSIONAL CONDUCT.

222. Sitkoff, *supra* note 16, at 2.

223. *See supra* Part IV.D (modeling the fiduciary gaps).

behavior of fiduciaries, the more confused beneficiaries become about what their legal protections are and the larger the gap grows. A clear understanding of where legal enforcement ends will help the parties to reach more efficient agreements and to protect themselves better as they come closer to an optimal degree of trust.

A. Dialing Down the Rhetoric

Courts in fiduciary cases frequently turn to moralistic rhetoric to explain how they think fiduciaries should act.[224] Cardozo's well-known language was extensively quoted above.[225] In corporate law, the Delaware Supreme Court uses strong moral terms to admonish corporate directors and to proclaim standards of behavior that it may consider disloyal.[226] Yet, almost simultaneously, the Delaware court noted that the bar for liability under these standards would be quite high,[227] and it comes as no surprise to anyone that truly egregious behavior would be subject to liability under any one of a number of standards. In *Market Street Associates*, Judge Posner warns about the harm that the moralistic rhetoric in good faith cases may cause and states that gap-fillers are not moral terms, but then states that a fiduciary "is required to treat his principal as if the principal were he," which overstates the duty of loyalty.[228] Even while denouncing moralistic rhetoric, Posner adds some of his own rhetoric by overstating a fiduciary's obligation to his beneficiary and exacerbating the problem.[229] In cases applying strong moral rhetoric, the actual holdings with regard to the duties of loyalty and care remain within the bounds of the fiduciary duties as conventionally and narrowly understood.[230]

The rhetoric is very influential, however. It shapes lawyers', judges', and scholars' views of what fiduciary duty means. It also influences societal understandings, perhaps leading beneficiaries to have higher expectations of their fiduciaries than the law can enforce. The notion that fiduciaries are supposed to act in our best interests, and only our best interests, and to care for us in performing their end of our bargain, as though they want nothing but the best for us, is deeply embedded in lay understandings of fiduciary

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224. *See* Claire Hill & Brett McDonnell, *Executive Compensation and the Optimal Penumbra of Delaware Corporation Law*, 4 VA. L. & BUS. REV. 333, 354–57 (2009) (describing Delaware judges' "norm-setting role" accomplished through judge-authored dicta, speeches, and articles).

225. *See supra* notes 14–15 and accompanying text (highlighting Chief Judge Cardozo's statement that fiduciaries must act with a "punctilio of an honor most sensitive" and must renounce "thought of self").

226. Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[T]he requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition, 'of the fundamental duty of loyalty.'"); *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 754 (Del. Ch. 2003) ("Bad faith can be the result of 'any emotion [that] may cause a director to [intentionally] place his own interests, preferences or appetites before the welfare of the corporation,' including greed, 'hatred, lust, envy, revenge, . . . shame or pride.'" (quoting Guttman v. Huang, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003))).

227. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009) (stating that a breach of the duty of care occurs when directors fail to do everything they need to do in a given situation); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–70 (Del. Ch. 1996) (explaining that a claim against directors for a breach of care is likely one of the hardest claims to prove).

228. Mkt. St. Assocs. Ltd. P'ship v. Frey, 941 F.2d 588, 593 (7th Cir. 1991).

229. *Id. Market Street* is a good faith case, not a fiduciary duty case, so everything Judge Posner says about fiduciary duties qualifies as dicta and only serves to provide additional commentary about understandings of fiduciary law. It does not contribute to fiduciary doctrine.

230. *See supra* Part IV.D.2.a (describing the trust relationship in the context of the duty of loyalty).

obligation.[231] That understanding of fiduciary obligation has become part of the language used to decide fiduciary cases, even though holdings in those cases do not enforce that standard.

One benefit of the rhetoric's influence is that it creates norms for fiduciary behavior.[232] This norm-creating expressive function of fiduciary rhetoric may be the greatest benefit of the unenforced moralistic language. It may result in or encourage trustworthy, loyal, careful fiduciary behavior in many instances where the relationship goes well. It may encourage that behavior in instances where liability for breach is never an issue and thereby make those relationships work better and encourage more people to enter into them. People often behave better than the law requires them to and moralistic rhetoric in fiduciary opinions may lead parties to believe that fiduciary relationships are worthy of a certain kind of behavior, even if liability does not enforce that standard. This expressive function of fiduciary opinions has long been considered their chief benefit.[233]

There are substantial costs to the moralistic rhetoric, however, that have thus far been largely ignored. The gap this Article identifies is a direct consequence of the overzealous rhetoric in fiduciary opinions that goes unenforced, and is not enforceable.[234] It creates a space between beneficiaries' justifiable expectations, the terms they think apply, and the standard of behavior they are able to enforce, the terms that actually apply. This gap gives beneficiaries of fiduciary duties, and perhaps many other trusting parties, the impression that the law provides more protection than it does. That is a problem because it may lead those parties to protect themselves inadequately. It makes them far more vulnerable than they would have been if they had properly understood the limits of the relationship and the limits of the law. The rhetoric then leads to over-trust and a non-optimal failure to take precautions. This cost cannot be ignored and must be weighed against the benefits of norm

231. At least some sources of the lay understanding of fiduciary obligation include dictionary definitions, what lawyers and scholars understand fiduciary obligations to mean, and what cases say. This Article has thoroughly explored what lawyers, judges, and legal scholars think fiduciary duties are and those experts are responsible for explaining their term of art, their doctrine to the rest of the population. The lay understanding is limited, in large part, by experts' explanations. Still, non-lawyers may turn to a dictionary or a search engine such as Google to find what fiduciary duties require. They would find that a fiduciary duty is most often described as an obligation to act wholly in another's best interest. *See, e.g.*, *Fiduciary Duty*, LEGAL INFORMATION INSTITUTE, http://www.law.cornell.edu/wex/fiduciary_duty (last visited Oct. 21, 2014) ("A fiduciary duty is a duty to act solely in another party's interests."); *Fiduciary*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, http://en.wikipedia.org/wiki/Fiduciary (last visited Oct. 21, 2014) ("In such a relation good conscience requires the fiduciary to act at all times for the sole benefit and interests of the one who trusts."); *Breach of Fiduciary Law & Legal Definition*, USLEGAL.COM, http://definitions.uslegal.com/b/breach-of-fiduciary-duty/ (last visited Oct. 21, 2014) ("A fiduciary duty is an obligation to act in the best interests of another party. . . . When one person does agree to act for another in a fiduciary relationship, the law forbids the fiduciary from acting in any manner adverse or contrary to the interests of the client . . . . The client is entitled to the best efforts of the fiduciary . . ."). These definitions can be as or more mistaken than the definitions carefully offered by experts. But with so much of the information provided to the law population erring in one direction, it is hard to see how non-lawyers could reach a different, less moralistic understanding of fiduciary obligation.

232. *See* Richard H. McAdams, *An Attitudinal Theory of Expressive Law*, 79 OR. L. REV. 339, 339–40 (2000) (arguing that the law affects behavior by communicating societal norms and expectations even when it does not prescribe particular sanctions to enforce those expectations). McAdams focuses on *law*, that is, legislation and judicial holdings. To the extent fiduciary rhetoric promises to give clues about outcomes in future cases or sets up expectations for the kinds of behavior that will garner approval or disapproval, it may have a similar effect.

233. Rock & Wachter, *supra* note 137, at 1697.

234. *See supra* Part IV (identifying the fiduciary gaps that duties and expectations create).

creation, especially since there are other ways to establish dominant norms. The expressive function of dicta must not do more harm than good.

The harm of misplaced expectations is evident in excessive, costly, non-meritorious litigation where trusting parties find the law will not enforce the terms they expected their agreement to contain.[235] It is evident when a trusting party thinks fiduciary duties applied only to find they did not.[236] It is evident in many forms of over-trust, even where fiduciary duties do not figure into the litigation.[237]

The rhetoric gives plaintiffs hope that fiduciary duties may be expanded in the next case. The language describing good faith in Delaware corporate law cases, for example, may give the impression that corporate fiduciary duties are expanding.[238] Prospective plaintiffs may believe that Cardozo's language will apply and that their case will call out for the application of a higher standard, a standard higher than the marketplace. But, in many circumstances, the parties to the agreement at issue are very much a part of the ordinary "workaday world"[239] and the only thing that elevates a fiduciary relationship is a prohibition of self-dealing by the fiduciary.

If we make clear to parties what fiduciary duties mean and how they are enforced, we will encourage them to find better ways to reach the appropriate agreements and protect themselves from the disappointment of their expectations in entering those agreements. If the limits of the law and legal liability are clearly communicated, then the market will develop other ways parties can protect themselves in sensitive, relatively vulnerable commercial situations. When they see the gap left by legal enforcement, they will be able to work to narrow it.

B. Improved Communication

Parties may begin to fill the gaps in their fiduciary contracts by avoiding them, that is, by specifying the terms that can be more carefully specified.[240] This may be as simple as clearly indicating whether (or not) fiduciary duties are the gap fillers of choice. By simply indicating whether fiduciary duties are the appropriate gap fillers, then the first, and often most difficult question to answer posed by trusting relationships, would be explicitly answered by the parties themselves. The parties would then avoid falling within some of

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235. *In re* Am. Int'l Grp., Inc. Consol. Derivative Litig., 965 A.2d 763, 795 (Del. Ch. 2009); *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 126–27 (Del. Ch. 2009); *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 778 (Del. Ch. 2003).

236. Eurycleia Partners, LP v. Seward & Kissel, LLP, 910 N.E.2d 976, 980–81 (2009) (holding that attorney–client relationship between hedge fund limited partnership and outside counsel that drafted fund's offering memorandum did not create a fiduciary relationship between counsel and the limited partners who invested in the fund); Schmidt v. Sheet Metal Workers' Nat. Pension Fund, 128 F.3d 541, 547–48 (7th Cir. 1997) (holding that trustees did not breach their fiduciary duties when their employee analyst misinformed participant and beneficiary).

237. Rubin v. Laser, 703 N.E.2d 453, 457 (Ill. App. Ct. 1998) (holding that a former trustee did not violate his duty of loyalty by making further purchases of bank stock for himself without purchasing any for trusts).

238. Gold, *supra* note 50, at 497.

239. Meinhard v. Salmon, 164 N.E. 545, 546 (1928) ("Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. 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.").

240. *But see* Hill, *supra* note 202, at 192 (arguing that parties to complex business transactions intentionally leave ambiguous or incomplete terms in their contracts to deter expensive litigation).

the most difficult parts of the model, where their expectations diverge and one party over-trusts. Of course, explicit communication may not completely solve the problem because some disclaimers or attempted waivers of fiduciary duties may be ineffective if the vulnerable party is still specifically induced to place trust in the trusted party. Again, there are no magic words that must be used to define a relationship as fiduciary. But encouraging parties to make the fiduciary term more salient, to negotiate specifically about it could lead to more complete negotiations and clearer agreements.

A more accurate understanding of how fiduciary duties are enforced will also encourage parties to reach better and more efficient agreements. When a trusted party is unwilling to submit to a duty of loyalty because it would like to pursue a conflicted interest while also serving the trusting party's interest in a particular situation (say, a real estate agent who wants to list more than one house in the same neighborhood), the trusted party will be more likely to clearly state that expectation. That is particularly true if it is clear that courts are enforcing parties' expectations and will enforce a hypothetical bargain should the need arise. The knowledge that their agreement and expectations will be relevant to determining the rights they will have if one party breaches, and that those rights will be limited, will encourage parties to communicate more extensively about gap filling mechanisms as well as any specific expectations they may have.

The object of enhanced communication between parties would be to move out of the hard cases with mistaken expectations and move toward a regime where parties choose the law they want. If fiduciary parties understand what duties will be enforced and that those duties are essentially contract terms, they may approach the relationships, at least in commercial contexts, more as they would other contracts. This would ultimately lead to parties' better protecting themselves, and agreeing more explicitly about what gap fillers they will use.

These communication practices would likely start with more sophisticated parties until they are common enough to become part of daily consumer negotiations. More sophisticated parties would know to negotiate about what duties they want to enforce and what risks they are willing to take. Baird and Henderson describe an analogous practice among sophisticated investors who are familiar with each other. The investors negotiate ex ante about the kinds of disclosures they will require of each other, writing "Big Boy" letters, agreeing not to rely on the other party's failure to disclose material, non-public information, or "anti-Big Boy" letters, requiring that the party signing the letter be treated as though the disclosing party owes them fiduciary duties.[241] In this way, very sophisticated parties are able to negotiate their expectations of each other thoroughly and decide what standards of care and loyalty they will each owe. Taking time for that negotiation and disclosure currently gives sophisticated parties enhanced flexibility in contracting. But similar practices could become common in industries where fiduciary duties are common or desired. In instances where one party is going to exercise discretion on another's behalf, whether or not the law would certainly recognize a fiduciary duty, parties wishing to avoid potential litigation may make an effort to define the relationship's terms more clearly. This is not to suggest at all that fiduciary duties could be freely waived or that sophisticated parties would be able to avoid the imposition of fiduciary duties with legalese and fine print. Rather, parties could be encouraged to develop better

241. Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1340–41 (2008).

communication practices in certain circumstances that may adjust the expectations of the parties and allow trusting parties to better protect themselves both by adjusting the level of trust they place in the trusted party and by avoiding harms for which the law may not provide a remedy.

C. Reputation

Parties that want to serve as fiduciaries or want others to trust them can establish trust by developing reputation for honest, loyal behavior toward their counterparties. By selecting more trustworthy fiduciaries, trusting parties may be able to avoid the costs of the gap between their expectations and enforceable duties by not having to sue to enforce the duties owed to them. Reputation is often a very effective mechanism for avoiding such loss, and, indeed, when it works, is much less expensive than ex post litigation.[242] Creating incentives for parties to establish reputations for trustworthiness lowers the cost of contracting for both fiduciaries and beneficiaries and lowers litigation costs, and so societal costs as well.[243]

Edward Iacobucci makes this point by illustrating that when one party has market power, informal enforcement mechanisms, like reputation, can be more effective than even formal legal enforcement of contract terms in driving the parties to perform optimally.[244] Iacobucci argues that parties with market power will forego short-term gains from opportunistic behavior to realize the long-term rewards of repeat business earned by maintaining a good reputation.[245] He shows that "sellers may adopt seemingly self-interested legal contracts, but may nevertheless act as though they were bound contractually to not act in a self-interested way because of self-enforcing agreements."[246] The agreements are self-enforcing (enforced by informal mechanisms) because the seller's market power gives it the potential to earn long-term profits from treating buyers fairly, profits that would be forfeited if the seller took advantage of the buyer in the short-term.[247] Iacobucci's theory fits neatly with the notion of fiduciary contracts outlined in this Article.

Fiduciary contracts are incomplete contracts that the law does not fully enforce. That is, the fiduciary gap cannot be filled with legal enforcement. Instead, some expectations of the parties, such as that the fiduciary will deliver a high-quality performance under the contract, are better enforced informally, through mechanisms such as reputation. Informal mechanisms work better than formal legal enforcement in these circumstances because legal enforcement is expensive, if available at all.[248] Also, informal agreements are more

242. Cooter & Freedman, *supra* note 33, at 1073 ("A fiduciary's faithful fulfillment of her undertaking enhances her reputation, which may have significant economic value.").

243. Benjamin Klein & Keith Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 616 (1981).

244. Edward M. Iacobucci, Market Conditions, Reputation and Contract Design 10 (January 2014) (unpublished manuscript) (draft on file with author).

245. *Id.* Klien and Leffler famously made this point about how market competition and reputation constrain parties to perform as agreed by providing high-quality rather than low-quality goods. Klein & Leffler, *supra* note 243, at 616.

246. Iacobucci, *supra* note 244, at 7.

247. *Id.* at 16.

248. *Id.* at 3.

easily modified as circumstances change, which is an important benefit when dealing with open-ended, discretion-based fiduciary agreements.[249]

According to Iacobucci, to the extent gains are to be shared from optimal performance, the party with the most market or bargaining power, in our case, the fiduciary, will realize most of those gains, thus having an incentive to develop a reputation for delivering high-quality performance.[250] Most fiduciaries entering into fiduciary relationships in commercial contexts hope to attract a number of clients over time. While each beneficiary may realize the benefits of the fiduciary's superior performance while she is relying on the fiduciary, the fiduciary is able to extract most of the gains from that performance by attracting more and more clients on the basis of her reputation. The fiduciary is the expert in the field and the repeat player, so she has the most to gain from thriving in the line of business she has chosen. Money spent on (potentially unsuccessful) litigation would be wasted in the face of the efficacy of informal enforcement mechanisms in such circumstances.

But when market power is low, Iacobucci posits that some protective formal contract terms may be warranted to provide basic protections.[251] In the fiduciary context, that may mean specifying more terms and giving the beneficiary ways to leave the relationship at various points at which evaluation of the fiduciary's performance would be feasible. A fiduciary with less market power may have less experience or a worse reputation, so would be less deserving of a stranger's trust. Such a fiduciary may have more to gain from short-term opportunism because it has not yet invested in long-term reputational gains. In such circumstances, there is almost no basis for high expectations and fewer incentives that would support any degree of trust at all. Then, it is more important for a beneficiary to specify her expectations and to insist upon specific terms in the contract that will provide formal remedies for certain instances of breach. A standard of devotion would remain unenforceable, but the relationship's goals and exit strategies could be specified and formally enforced.

The superior service that comes from the incentive to develop a strong reputation may serve trusting parties better and result in their trust being better placed. Then the beneficiaries may trust more without over-trusting, but they will rely on reputational penalties, in addition to legal ones, to define the bounds of their expectations that the fiduciary party will act with a particular degree of good will, honesty, and care.[252] A system of reputational consequences works most efficiently if its role is clearly defined. That is, if the gap in legal enforcement is large, and reputation has to carry a lot of weight in supporting the parties' expectations, then mechanisms for measuring and tracking

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249. *Id.* at 15.

250. *Id.* at 12 ("If providing high quality, and being known to provide high quality, creates value for the buyer and seller combined, then market power allows the seller to capture a significant share . . . of that value and thus increases the probability that the seller will seek to maintain a reputation for providing high quality. This in turn implies that formal contracts to provide high quality are less likely to be necessary, and that market power influences contract design.").

251. When interest rates are high and lending is riskier, so borrowers have less market power, Iacobucci observes that formal covenants in loan agreements are stricter. Iacobucci, *supra* note 244, at 12.

252. *See* Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 547–48 (1997) ("The fiduciary may have reputational incentives to act in the beneficiary's interests. . . . Thus, even if the fiduciary can cheat a given firm without legal consequences, inadequate performance could reduce the price of the fiduciary's services in other deals.").

reputation will develop to fill that space. Parties on both sides will work to find ways to signal reputation and either reward or punish various behaviors of trusted parties.

The natural development of a system of reputational sanctions will not progress quickly or efficiently if the parties believe litigation is their primary recourse. The moralistic rhetoric in fiduciary opinions gives trusting parties the mistaken impression that certain expectations can be satisfied via legal remedies. This belief will prevent them from investing in other more reliable and less costly systems for incentivizing trustworthy behavior.

Reputation has become increasingly important and easy to influence in the age of the Internet.[253] EBay notably uses reputation as an informal enforcement mechanism between its buyers and sellers when it induces trust among the parties trading on its site by using a system of reviews.[254] If a seller receives a bad review for failing to perform as agreed, buyers are significantly less likely to deal with that seller in the future. Such a system of reviews is necessary to induce consumers to send money to a stranger in the hopes that the stranger will mail the goods as agreed.[255] The parties would never meet and may not even know each other's real names. Legal enforcement would be far more difficult, especially for relatively low-value transactions, than informal enforcement through reviews. EBay sellers care very much about their reviews and may give even difficult buyers some advantages to avoid bad reviews and the loss of future business.[256]

Consumers can review just about anything online, including fiduciary service providers. Lawyers have online ratings that reflect the number of complaints against them, if any.[257] State bars also compile information about complaints, suits against barred attorneys, and censure bar members for misbehavior, even if no liability results.[258] The same resources are available to those choosing doctors.[259] It is important for trusting parties to know that reputational sanctions can begin where legal liability ends. To make the most of reputational sanctions, trusting parties must know what the limits of legal liability are. That way, they will do more to enhance reputational information systems.

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253. Lior Jacob Strahilevitz, *"How's My Driving?" for Everyone (and Everything?)*, 81 N.Y.U. L. REV. 1699, 1713 (2006) (listing Internet sites that use reputation to guide consumers and increase confidence in their products).

254. *Id.*

255. *Id.*

256. Strahilevitz also describes a "Pollyanna effect" whereby buyers and sellers give each other excessively positive reviews to avoid receiving bad reviews in retaliation. *Id.* at 1754–55.

257. *See generally Find a Lawyer*, AVVO, http://www.avvo.com/find-a-lawyer (last visited Oct. 4, 2014) (providing attorney listings containing information on disciplinary actions and reviews); *Martindale*, MARTINDALE-HUBBELL, http://www.martindale.com (last visited Oct. 4, 2014) (containing a legal directory and rating system).

258. *E.g.*, *Attorney Discipline*, THE FLORIDA BAR, http://www.floridabar.org/attorneydiscipline (last visited Sept. 15, 2014) (containing resources on Florida attorney discipline); *Lawyer Regulation*, THE STATE BAR OF CALIFORNIA, http://www.calbar.ca.gov/Attorneys/LawyerRegulation.aspx#1 (last visited Sept. 15, 2014) (containing resources on California attorney discipline); *Resolving Conflict with a New York Attorney*, NEW YORK STATE BAR ASSOCIATION, https://nysba.org/resolvingconflict/ (last visited Sept. 15, 2014) (containing resources on New York attorney discipline).

259. *See generally* HEALTHGRADES, http://www.healthgrades.com (last visited Oct. 4, 2014) (offering health care provider reviews); *Complaint Process FAQs*, FLORIDA BOARD OF MEDICINE, http://www.flboardofmedicine.gov/complaints-process-faqs/ (last visited Sept. 15, 2014) (describing procedures for filing a complaint against medical professionals in Florida).

VII. CONCLUSION

Fiduciary relationships are a species of contract and, thus, contain gaps. Fiduciary relationships contain particularly large gaps because beneficiaries of fiduciary duties often lack the time and expertise to monitor the fiduciary's behavior closely, and many fiduciary tasks require significant discretion. Fiduciary duties fill many of the gaps in the agreements, helping courts determine what the parties would have agreed if they had negotiated a particular term in advance. But courts cannot honor all of the parties' expectations or enforce all of the terms they might have agreed to at the outset because beneficiaries may expect too much of their fiduciaries. In this Article, I have revealed the gap that exists between the parties' expectations about their terms and the terms courts will enforce, which I call the fiduciary gap.

The fiduciary gap, which cannot and should not be filled by the law, causes much of the confusion and debate surrounding fiduciary relationships. If courts are only willing to enforce the agreements of fiduciary parties to the extent they conform to well-defined fiduciary duties then they will not be able to enforce all of the intended terms of some fiduciary agreements. The gap is necessary, but so is a better understanding of the bounds of fiduciary duty and the potential size of the unfillable gap.

Rather than encouraging more trustworthy behavior through moralistic rhetoric, courts should be honest with fiduciary parties about the limits of fiduciary liability. Only honesty will help cabin beneficiaries' expectations, thereby closing the gap between mistaken expectations and enforceable duties. Further, with the limits of the law in mind, beneficiaries can turn to other, supra-legal mechanisms to protect themselves. Understanding the contractual nature of fiduciary enforcement may lead fiduciary parties to communicate more effectively about their expectations and may encourage them to create systems to share the reputation information of various trusted parties and to punish those who deviate from the most desirable standard of behavior for trusting parties.