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Resolving Conflicts of Duty in Fiduciary Relationships

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Resolving Conflicts of Duty in Fiduciary Relationships

Keywords

fiduciary duty, conflicts of duty, acts and omissions, Kant

RESOLVING CONFLICTS OF DUTY IN FIDUCIARY RELATIONSHIPS*

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INTRODUCTION

The path walked by a well-meaning fiduciary is fraught with peril. Trustees, lawyers, company directors, and other fiduciaries are bedeviled by conflicts owed to multiple principals. Should an attorney, for example, violate one client's trust by disclosing information that could result in the acquittal of another client wrongly accused of a crime? Should a trustee continue to loan trust assets to a company on which he serves as a director after learning privately that the company is doomed? In these situations, the fiduciary is faced with a challenging dilemma. He can respect the wishes of one principal, but in doing so, he may fail to perform his duty to another. How should a fiduciary resolve such a conflict?

The principal debate attending fiduciary duties over the past twenty-five years has sidestepped this question and focused on others instead. A large body of literature contends that fiduciary duties are barnacles on the ship of contract, default contractual terms to which the parties would agree if they had the benefit of unlimited resources.¹ While this debate helps place fiduciary duties under the

1. See generally ALAN R. BROMBERG & LARRY E. RIBSTEIN, PARTNERSHIP § 6.07(a), at 6.110-111 (Aspen Publishers Supp. 2003-2) (1988) (explaining that “[f]iduciary duties are essentially part of the standard form contract that governs partnership in the absence of contrary agreement”); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) (describing the fiduciary relation as contractual and subject to high costs of specification and monitoring); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1982) (theorizing that investors and agents would bargain for fiduciary rules if an agreement on such rules could be made at no cost); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 629 (1995) (purporting that fiduciary duties in trust law are “unambiguously contractarian” despite the desire to hold fiduciary obligations sacred); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 28 (1991) (claiming that fiduciary duties are a legal construct which fill in the unspecified terms of shareholders’ contingent contracts); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder*

rubric of contract law, it does not address conflicts between and among principals faced by fiduciaries. A related body of literature has evolved surrounding the source of the fiduciary relationship. Many commentators have argued that fiduciary relationships arise from a grant of power or authority from the principal to the fiduciary to act on the principal's behalf.² While this discussion helps to account for when fiduciary duties arise, it does not address how to resolve conflicts of duties owed to multiple principals.

This Article attempts to fill the gap and presents an account for how courts decide such cases. It demonstrates that one can best understand the way courts resolve these conflicts by analyzing the nature or character of the particular duties imposed. This Article will

Constituencies from a Theory of the Firm Perspective, 84 CORNELL L. REV. 1266, 1273 (1999) (concluding that fiduciary duties are essentially contractual in nature). Other commentators are critical of the contract model. See, e.g., Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 63 (John W. Pratt & Richard J. Zeckhauser eds., 1991) (noting that courts have failed to delineate how fiduciary duties fill in contractual gaps and ambiguities); Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 768 (2000) (noting that cognitive factors lead courts to analyze property-based fiduciary relationships differently than contractual relationships); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 627 (1997) (contrasting the neutral character of restrictions on opportunistic behavior imposed by background contractual terms with fiduciary rules that are comprehensive and one-sided); Deborah H. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 889-90 (1988) (contending that "the 'hypothetical bargain' view of fiduciary obligation does not help to explain the law"); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1266 (1995) (highlighting the insufficiency of the contract model for fiduciary relationships because it relies on trust); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 478 (1993) (challenging those who predicate the notion of fiduciary loyalty on efficiency because such an explanation misses both the nature and importance of trust).

2. Fiduciary duties are said to arise as a constraint on opportunism presented to the fiduciary by virtue of the power or authority he receives from the principal. See, e.g., Alexander, *supra* note 1, at 774-75 (comparing the horizontal and the vertical nature of non-fiduciary and fiduciary relationships); Victor Brudney, *Fiduciary Ideology in Transactions Affecting Corporate Control*, 65 MICH. L. REV. 259, 275 (1966) (proposing that the fiduciary ideology is a "prophylactic prohibition" where the opportunity to benefit the trustee is large and unclear whether the beneficiary is deprived of anything); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1048 (1991) (charging that the separation of ownership from control or management creates opportunities for the agent to skim assets); Robert Flannigan, *The Fiduciary Obligation*, 9 OXFORD J. LEGAL STUD. 285, 295 n.46 (1989) (stating that the access to assets can create fiduciary status because it provides the opportunity for abuse); Frankel, *supra* note 1, at 1224 n.37 (explaining that fiduciary law is founded on the need to prevent one person from misappropriating another person's valuables); Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 825 (1983) (determining that the fiduciary duty fluctuates according to the degree of potential abuse of power stemming from the relation); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1444 (2002) (justifying the decision to impose fiduciary duties on the ability of the fiduciary to act opportunistically); Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975) (characterizing the fiduciary obligation as a "blunt tool" for the control of fiduciary discretion).

show that the two main branches of fiduciary duty—the duty of loyalty and the duty of care—differ in character. The duty of loyalty is primarily a negative duty *not to harm the principal*, and it is unambiguous in what it requires. The duty of care is positive—a duty to *promote the ends of the principal*—and it is open-ended and variable in nature. When duties of loyalty and care collide, courts generally resolve the conflict in favor of the duty of loyalty representing minimum conduct to which the fiduciary must adhere.

The central thrust of the Article is explanatory. Courts deciding conflicts of duty cases in many areas of fiduciary law base their decisions on theories or doctrines applied on an *ad hoc* basis. Underlying the cases is a tension between promoting the duty of loyalty or the duty of care, but not both. In each case, courts resolve the tension by enforcing the duty of loyalty to one principal even if it results in a diminution in the duty of care to another. Once this principle is uncovered, the cohesiveness of the cases becomes clear. They are decided on a rational basis consistently applied. This Article's objective is to explain that conflict of duty cases—regardless of the type of fiduciary involved—are coherent at their core.

To assist in this explanation, I trace the differences between the duty of loyalty and the duty of care to Immanuel Kant's discussion of perfect and imperfect duties. Kant divided all duties into these two categories, and the difference between them illuminates the difference between the duty of loyalty and the duty of care. An examination of fiduciary duties in light of Kant's perfect and imperfect duties is absent from both the legal and philosophical literature. I explore this analogy and conclude that comparing Kant's perfect and imperfect duties with the fiduciary's duties of loyalty and care helps explain and justify why courts treat breaches of the duty of care more leniently than breaches of the duty of loyalty. And it provides the key to resolving conflicts of duty in favor of the duty of loyalty, not the duty of care.

Understanding the nature of loyalty and care in fiduciary relationships, and how it bears on resolving conflicts of duty, is important and timely. Many of our affairs are entrusted to fiduciaries such as attorneys, investment professionals, company directors, and others. The decisions they make on our behalf can govern our health, affect our property, determine our retirement savings, and influence our well-being in numerous other ways. In some areas, such as corporate governance, the fiduciary's role is undergoing scrutiny and reevaluation. The numerous corporate failures and mutual fund scandals in the United States have directed attention to

the role of company boards and whether directors are performing their duties adequately. Thus, while fiduciary duties historically have evolved through the common law, in recent years, Congress,³ the Securities and Exchange Commission,⁴ the American Bar Association,⁵ and others⁶ are grappling with ways to minimize breaches of fiduciary duty.

3. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 301, 402, 307, 116 Stat. 745 (2002) (regulating accounting, auditing, and corporate governance extensively, including setting forth the requirements governing the responsibilities of audit committees (§ 301), prohibiting loans to officers and directors of public companies (§ 402), and requiring the reporting by lawyers of certain violations of law (§ 307)).

4. See, e.g., Investment Adviser Code of Ethics, Investment Advisers Act Release No. 2209, 69 Fed. Reg. 4040-01 (Jan. 27, 2004) (expressing concern that the obligations of the duty of loyalty are lost on the growing number of advisers in the enforcement calendar), available at <http://www.sec.gov/rules/proposed/ia-2209.htm>; Compliance Programs for Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204, 68 Fed. Reg. 74714-01 (Dec. 24, 2003) (noting that the rule requires advisers to consider their fiduciary duties under the Advisers Act and to shape procedures to address them), available at <http://www.sec.gov/rules/final/ia-2204.htm>; Management's Report on Internal Controls Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Securities Act Release No. 8238, 68 Fed. Reg. 36636-01 (June 18, 2003) (stating that the rule amendments are meant to improve disclosure about the extent of management's responsibility for financial statements, internal controls, and means by which management discharges responsibilities), available at <http://www.sec.gov/rules/final/33-8238.htm>; Standards Relating to Listed Company Audits, Securities Act Release No. 8220, 68 Fed. Reg. 18788-01 (Apr. 16, 2003) (increasing the competence of audit committees to improve accountability and the quality of financial disclosure and oversight), available at <http://www.sec.gov/rules/final/33-8220.htm>; Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, 68 Fed. Reg. 6296-01 (Feb. 6, 2003) (observing that these requirements will make it more likely that companies will address misconduct internally and remedy violations at earlier stages), available at <http://www.sec.gov/rules/final/33-8185.htm>.

5. See American Bar Association, *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145, 147 (2003) (providing analysis and recommendations to govern behavior "that conforms to law and results from the proper exercise of fiduciary duties of care and loyalty").

6. See, e.g., GEORGE BENSTON ET AL., FOLLOWING THE MONEY: THE ENRON FAILURE AND THE STATE OF CORPORATE DISCLOSURE 49-80 (2003) (proposing ways to fix corporate disclosure, such as incremental reforms, the formulation of a global standard, innovative monitoring, and improved incentives); IRA M. MILLSTEIN & PAUL W. MACAVOY, THE RECURRENT CRISIS IN CORPORATE GOVERNANCE 114 (Palgrave Macmillan 2004) (charging that board members recognize their duty to those who count on their honesty, loyalty, and good faith for protection); Lawrence A. Cunningham, *Crisis in Confidence: Corporate Governance and Professional Ethics Post Enron*, 35 CONN. L. REV. 915, 919-20 (2003) (endorsing Sarbanes-Oxley's expanded penal net, but criticizing Congress's failure to take responsibility for its own contribution to corporate mis-governance); Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 29 (2003) (reinforcing the notion that loyalty should be central to corporate well-being, especially after Enron); David Millon, *Who "Caused" the Enron Debacle*, 60 WASH. & LEE L. REV. 309, 312 (2003) (exploring the gatekeeper's function and the relevance of causing liability to minimizing breaches of fiduciary duties); Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333, 339 (2002) (suggesting that Enron's collapse may

The Article proceeds in three parts. Part I begins with an overview of the problem. It describes circumstances in which a fiduciary faces a conflict and is left with no choice but to breach one duty in order to perform another. Part I also discusses approaches to address such conflicts and why the approaches do not explain consistently how such cases have been resolved. Part II discusses how the twin duties imposed in a fiduciary relationship—the duty of loyalty and the duty of care—differ in character. The duty of loyalty is a duty of omission, requiring the fiduciary to refrain from conduct harmful to the principal. The duty of loyalty is an example of Kant’s perfect duties. The duty of care is a duty of commission, requiring the fiduciary to engage in conduct for the benefit of the principal. Yet no rule or set of rules can fully describe the duty of care. Rather, the fiduciary must make the well-being of the principal his goal and act accordingly. The duty of care is an example of Kant’s imperfect duties. Part III applies these principles to several cases and posits that such principles, whether articulated or not, account for how the cases are decided. Part III explains that when courts must determine whether to enforce the duty of loyalty or the duty of care, they opt to enforce the duty of loyalty. Negative duties triumph over positive ones; duties of omission triumph over duties of commission.

I. CONFLICTS OF DUTY

A fiduciary relationship is a relationship of trust and confidence where one party (the principal) places control over her property or affairs with another (the fiduciary), and the fiduciary agrees to act in the principal’s benefit with respect to her property or affairs.⁷ Some

cause us to reexamine the public responsibility of private corporations and the fiduciary duty of disclosure of corporate directors); Symposium, *Van Gorkom and the Corporate Board: Problem, Solution, or Placebo*, 96 NW. U. L. REV. 447 (2002) (discussing the *Van Gorkom* duty of care standard); Kurt Eichenwald, *In String of Corporate Troubles, Critics Focus on Boards’ Failings*, N.Y. TIMES, Sept. 21, 2003, at A1 (questioning whether members of corporate boards always work on their investors’ behalf); David Gische & Jo Ann Abramson, *Corporate Fiduciary Liability Claims in the Post-Enron Era*, at <http://articles.corporate.findlaw.com/articles/file/00295/008474> (last visited Jan. 31, 2005) (stating that ERISA class action lawsuits against corporate directors for breach of fiduciary duty are troubling because they (i) expand the definition of fiduciary to include officers not directly responsible for plan assets, and (ii) impinge on otherwise regulated fields, such as the disclosure of financial performance) (on file with the American University Law Review).

7. A general comprehensive definition of fiduciary does not seem to exist. See Weinrib, *supra* note 2, at 5 (stating that the designation of a company’s fiduciary is a “notoriously intractable problem”). In fact, courts often are reluctant to define “fiduciary” to avoid the negative implication that relationships not included in the definition are excluded. See, e.g., *Harper v. Adamez*, 113 A.2d 136, 139 (Conn. 1955) (declining to define a fiduciary relationship in precise detail). The definition of “fiduciary” in the RESTATEMENT (SECOND) OF TORTS is circular in part, and it leaves

fiduciary relationships are well established; other relationships may give rise to fiduciary duties depending on the facts and circumstances of a particular situation.⁸ In all cases, fiduciaries can face conflicts between and among multiple principals the moment they agree to act on behalf of more than one. Part I presents the existence of such conflicts and the manner in which they are purportedly resolved.

A. *The Problem*

Most fiduciaries act for more than one principal. A trustee generally administers more than one trust; an attorney represents more than one client; a company director may sit on multiple boards. The Second Restatement of Agency provides, unless agreed, that an agent may not act for persons whose interests may conflict.⁹ But the Restatement also recognizes that some conflicts may not be foreseeable, and an agent may act for principals with conflicting

unanswered the question of when a fiduciary duty arises. See RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1977) (defining a fiduciary relation as one that exists between two persons when one person is under a duty to act for the benefit of the other). Other courts also have expressed the difficulty, if not the impossibility, of formulating a definition of fiduciary to capture all cases. See *Steelvest, Inc. v. Scansteel Serv. Ctr., Inc.*, 807 S.W.2d 476, 485 (Ky. 1991) (stressing the impossibility of formulating a definition of a fiduciary relationship that would fully and adequately embrace all cases); *Brown v. Foulks*, 657 P.2d 501, 506 (Kan. 1983) (stating that it is difficult to define the term “fiduciary relation”). A large body of literature has emerged addressing the characteristics of the fiduciary relationship. See generally *Varity Corp. v. Howe*, 516 U.S. 489, 504 (1996) (identifying the primary function of the fiduciary duty as the constraint on exercising discretionary powers); Flannigan, *supra* note 2, at 297 (explicating that trust is a single source of the obligation); Tamar Frankel & Wendy Gordon, *Trust Relationships*, 81 B.U. L. REV. 321, 323-24 (1981) (highlighting the role of trust in fiduciary relationships); Weinrib, *supra* note 2, at 7 (identifying the hallmark of a fiduciary relation as one person’s commitment to another).

8. Conventional fiduciary relationships include trustee and beneficiary, attorney and client, guardian and ward, executor and heir, and director and shareholder. Examples of unconventional fiduciary relationships are stockbroker and customer, accountant and client, and director and bondholder. See, e.g., Flannigan, *supra* note 2, at 293-94 (noting that a fiduciary relationship is established where confidence or deferential trust is shown to exist); see also Cheryl Goss Weiss, *A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty*, 23 J. CORP. L. 65, 112-14 (1997) (examining whether brokers are fiduciaries). Others use the terms formal and informal in place of conventional and unconventional. See Smith, *supra* note 2, at 1412 & n.51 (labeling trustee-beneficiary, guardian-ward, partner-partner, director-shareholder, and attorney-client relationships as formal and general confidential relationships as informal); see also DeMott, *supra* note 1, at 909 (discussing the unconventional aspect of fiduciary relationships).

9. RESTATEMENT (SECOND) OF AGENCY § 394 (1958); see also *N.L.R.B. v. Amax Coal Co.*, 453 U.S. 322, 329-30 (1981) (arguing that the rule against a trustee dividing his loyalties must be rigidly enforced to deter the trustee from all temptation and to prevent any possible injury to the beneficiary).

interests if the agent did not intend to create a situation where a conflict may arise.¹⁰

In what kinds of cases would a conflict between legitimate interests arise? A fiduciary that offers even one service, such as a trustee or advisory service, may encounter conflicts the moment representation of multiple principals occurs. Some of these conflicts present questions over how to allocate scarce resources. Some have questioned whether a director who sits on eighty or one hundred boards can effectively monitor the activity of each.¹¹ Similarly, one can ask if an attorney with multiple clients should spend time preparing one case over another. An investment manager may be required to place a valuable investment in the account of one client and not another. The same investment manager may also have to sell an illiquid security from several accounts, driving the price of that security down. Determining which clients sell first, therefore, presents a conflict.¹² Perhaps the clearest problem arises when a trustee sells assets from one account to another. In that case, the trustee is both purchaser and seller. As seller, the trustee seeks to sell dear, and as buyer, to buy low.¹³ A company director in the case of a

10. RESTATEMENT (SECOND) OF AGENCY § 394 cmt. b (1958). I shall not, in this Part, address conflicts of interest that arise when a fiduciary is motivated by self-interest. Much of fiduciary law, explored more fully in Part II, is based on how to ensure a fiduciary does not take advantage of opportunities for self-dealing. The focus here, rather, is limited to situations where two or more principals have legitimate interests and the fiduciary is placed in the delicate role of determining which interest prevails. This problem facing the fiduciary may be characterized as a distinction between conflicts of interest and conflicts of duty. How can one blame a fiduciary in an untenable situation wanting to do the right thing? Put this way, the focus is on the intent of the fiduciary as opposed to the consequences of the fiduciary's actions. It is little comfort to the fiduciary's principal, however, that the fiduciary is not acting out of self-interest but rather in the interest of another principal. This debate arises in the context of criminal law as well. See generally GEORGE P. FLETCHER, *A CRIME OF SELF-DEFENSE: BERNHARD GOETZ AND THE LAW ON TRIAL* 60-83 (Univ. of Chicago Press 1990) (1988) (discussing Goetz's choice to shoot four men on the subway in light of his intent and the consequences of his actions).

11. *Mutual Funds: Trading Practices and Abuses That Harm Investors: Hearings Before the Subcomm. on Financial Management, the Budget, and International Security of the Senate Comm. on Governmental Affairs*, 108th Cong., 1st Sess. 1-4 (2003) (statement of Senator Collins).

12. See generally AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRACHTER, *THE LAW OF TRUSTS* §§ 169, 170 (4th ed. 1987 & Supp. 2000) (indicating that the most fundamental duty of trustee is the duty of loyalty owed to the beneficiaries of a trust and the duty of the trustee is to administer the trust for the sole interest of the beneficiaries).

13. The Uniform Trusts Act expressly forbids this practice. See UNIF. TRUSTS ACT § 6 (1937) (forbidding the trustee of one trust from selling property to itself as the trustee of another trust). Most states, however, permit such transfers as long as the price is considered fair. See GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 543 (H) (1993) (noting that most states adopt a middle ground approach, where the transaction is unassailable by the beneficiaries unless there is unfairness); SCOTT & FRACHTER, *supra* note 12, at § 170.6 (forbidding straw

self-tender has a similar conflict because he represents both the company conducting the offer and the shareholders to whom the offer is directed.¹⁴ Striking a proper balance may be difficult.

In other cases, striking a proper balance may be impossible. Some fiduciaries face conflicts whereby acting to the benefit of one principal necessarily harms another.¹⁵ These cases may be considered strict conflicts because the fiduciary has a reason to take the action, but the same fiduciary also has a reason to refrain from taking the same action.¹⁶ Consider the example of a defense attorney representing two codefendants, both of whom claim they were not present at the scene of a crime. A prosecution eyewitness testifies to seeing both individuals at the crime scene, but the witness's memory is weaker with respect to the second. The defense attorney is in a bind. Attempts to impeach the witness's testimony with respect to the second defendant will call attention to the fact that the witness's testimony with respect to the first is sound. Should the defense attorney question the witness and attempt to impeach or forgo cross-examination?

While representation of multiple principals may cause conflicts for a fiduciary that offers a unitary service, conflicts are more likely to arise when a fiduciary offers multiple services to multiple clients.¹⁷ Organizations enhance their efficiency by offering multiple services, and courts recognize that large financial firms have done so for decades.¹⁸ The activities of many financial firms can be divided

transactions if they involve a third person, but not if they involve a fiduciary operating alone); Fiduciary Activities of National Banks Regulations, 12 C.F.R. §9.12(d) (1996) (allowing a national bank serving as fiduciary to sell assets between fiduciary accounts if the transaction is fair and not prohibited by applicable law).

14. See *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1057 (Del. Ch. 1987) (explaining that directors act as both the representatives of the corporation and the fiduciaries for the shareholder-offerees, giving rise to potential conflict on the part of the directors).

15. *But cf.* JOSEPH RAZ, PRACTICAL REASON AND NORMS 188 (2002) (proposing that conflicts need not be mutually exclusive).

16. See *id.* at 25, 188 (postulating that conflicts of reason, which occur when the agent has reasons to perform and not to perform a certain act, should not necessarily preclude the pursuit of that act).

17. See TWENTIETH CENTURY FUND STEERING COMMITTEE ON CONFLICTS OF INTEREST IN THE SECURITIES MARKETS, ABUSE ON WALL STREET: CONFLICTS OF INTEREST IN THE SECURITIES MARKETS 7 (1980) (noting that modern firms perform a "multiplicity" of functions, such as the execution of orders to buy and sell stocks, buy and sell bonds, provide investment advice, and underwrite new issues, which further complicate conflicts of interest); Note, *Conflicting Duties of Brokerage Firms*, 88 HARV. L. REV. 396, 420 (1974) (recommending a system where the fiduciary, upon entering a confidential relationship, notifies customers that previous recommendations from an outside perspective will no longer be updated).

18. See *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 249 (S.D.N.Y. 2003) (noting that the affiliation between mutual fund

roughly into two categories, investment banking and retail brokerage, and the cyclical nature of revenue from brokerage often is offset by more consistent revenues from investment banking.¹⁹ Offering multiple services, however, may present tensions in the organization and lead to conflicts between and among customers and clients.²⁰ A firm that both underwrites securities and provides brokerage services, for example, faces competing claims of its clients. Over forty years ago, the SEC noted that the variety of functions performed by securities firms—including underwriting and retail brokerage—results in “multifarious possibilities of conflict of obligation or interest” since “each of these functions involves its own set of obligations to particular persons or groups of persons.”²¹ These conflicts are as salient today as they were in 1963. The *New Yorker* recently noted:

The overriding conflict is that most major firms . . . run both investment banks and brokerages. Investment bankers help companies sell stocks and bonds. Brokers help investors buy stocks and bonds. Companies want to sell high, investors want to buy low. Companies want Wall Street to make them look good, investors want Wall Street to tell them which companies actually are good. When the same firm is advising both sides, someone is going to get a raw deal, even if everyone is acting honestly.²²

Recent federal and state actions against Jack Grubman, Henry Blodget, and ten large investment firms demonstrate conflicts that exist in financial firms.²³ The investment banks exercised extraordinary and inappropriate influence over research analysts whose job it was to be objective seers of the facts.²⁴

investment advisers and broker-dealers has been recognized for decades).

19. JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 214 (3d ed. 2001).

20. See NORMAN S. POSER, *BROKER-DEALER LAW AND REGULATION* 31-38 (1995) (chronicling the potential conflicts of interest that arise in a multi-function financial firm).

21. See SECURITIES AND EXCHANGE COMMISSION, *REPORT OF SPECIAL STUDY OF SECURITIES MARKETS*, H.R. DOC. NO. 95, pt. I, at 439 (1st Sess. 1963) (discussing the emerging pitfalls in directorships and broker-dealer trading and calling for “vigilant concern for niceties of conduct”).

22. James Surowiecki, *In Wall Street We Trust*, *THE NEW YORKER*, May 26, 2003 at 40.

23. See, e.g., *In re WorldCom, Inc. Sec. Litig.*, No. 03 Civ. 2841, 2004 WL 2075173 (S.D.N.Y. Sept. 17, 2004) (detailing the case against Jack Grubman); *In re Merrill Lynch & Co., Inc. Research Reports Sec.*, No. 01 Civ. 6881, 2004 WL 305601 (S.D.N.Y. Feb. 18, 2004) (detailing the case against Henry Blodget).

24. The SEC and the New York Attorney General alleged that the investment banking departments of ten large firms exercised improper influence over research to curry favor with certain companies and to generate investment banking business. See Joint Press Release, SEC, New York Attorney General, North American Securities Administrators Association, NYSE and NASD, *Ten of Nation's Top Investment Firms*

Conflicts of duty can also arise when a company director takes on the function of a trustee, and trust assets are invested in the company's stock or debt.²⁵ The director-trustee may face tough choices between taking risk-enhancing steps to increase the price of the stock, thereby promoting the well-being of the company shareholders, and refraining from taking such steps to ensure the well-being of the trust beneficiaries, who typically are risk-averse. Similarly, a company officer may act as a trustee to a company pension plan and face similar conflicts between a duty to the company's shareholders and a duty to the plan members.²⁶

Perhaps the most typical conflict results from the fiduciary's duty of confidentiality.²⁷ Certain services, such as banking, trust, or advisory services, place a high value on client confidentiality, while other services, such as underwriting or brokerage, require detailed disclosure. A fiduciary offering two or more of these services may be pressed to disclose information to one client that another insists be kept confidential. An attorney, for example, may learn of confidential information through the course of representation of one client that is vital to the representation of another.²⁸ Similarly, a

Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003) (summarizing the charges against the ten firms and introducing reforms to insure that the ties between brokerage and investment banking will be permanently severed), *available at* <http://www.sec.gov/news/press/2003-54.htm>; *see also* Federal Court Approves Global Analyst Research Settlement, SEC Litig. Release No. 18438, 81 SEC Docket 1699, 1699 (Oct. 31, 2003) (summarizing the allegations of the SEC's complaint and the terms of the settlement, wherein the firms agreed to pay approximately \$1.4 billion and implement structural reforms), *available at* <http://www.sec.gov/litigation/litreleases/lr18438.htm>.

25. *See Note, The Trust Corporation: Dual Fiduciary Duties and the Conflict of Institutions*, 109 U. PA. L. REV. 713, 717 (1961) (explaining that when two institutions share a common fiduciary a breach of duty is likely to occur because an act on behalf of one institution may not be in the best interests of the other).

26. Section 408(c)(3) of ERISA permits a company officer to act as a trustee for an ERISA pension plan, Employee Retirement Income Security Act of 1974 § 408(c)(3), 29 U.S.C. § 1108(c)(3) (2004), but section 404(a)(1) provides that the plan must be administered "for the exclusive purpose of . . . providing benefits to participants and their beneficiaries." *See Siskind v. Sperry Retirement Program*, 47 F.3d 498, 500 (2d Cir. 1995) (observing the appearance of a conflict of interest when ERISA trustees hold corporate offices); *Donovan v. Bierwith*, 538 F. Supp. 463, 468-69 (E.D.N.Y. 1981) (discussing the duties owed by a pension fund trustee who is also a company director, and the extent to which ERISA permits this overlap), *aff'd*, 680 F.2d 263 (2d Cir. 1982) (Friendly, J.). *See generally* David I. Weiss, *Conflicts of Interest Arising Under ERISA's Fiduciary Standards: Can the Trustee Ever be Prudent, as Long as He Faces Dual Loyalties?*, 9 NOVA L.J. 413, 413 (1985) (criticizing the enactment of § 408(c)(3) of ERISA, which permits corporate officers to act as trustees for pension plans, and thus, allows the exposure of ERISA pension plans to loss of funds at the hands of disloyal corporate officers/trustees).

27. *See generally* Mitchell, *supra* note 2, at 478 (stressing that fiduciary relationships are based on trust and loyalty).

28. *See* Lauren Cohen, Note, *In-House Counsel and the Attorney-Client Privilege: How*

company director serving on multiple boards may learn of confidential information from one that would be beneficial to another.²⁹ Our instincts tell us that the director should keep the information of the first confidential, but why is this the case if doing so does a disservice to the second?³⁰ A company director who serves as a trustee and invests trust assets in the company's shares similarly may be privy to non-public information bearing on the price of the shares. If the trustee learns that the company is doomed, is the trustee duty-bound to sell? Is selling the shares permitted, but not required?

B. *Approaches to Addressing Conflicts of Duty*

Current law has taken several approaches to resolving conflicts of duty, none of which is wholly satisfactory. Five possible approaches, which find expression in the case law, are (i) balancing the interests; (ii) applying a property theory; (iii) applying the doctrine of *actio libera in causa*; (iv) determining which duty arose first; and (v) seeking the advice of a neutral third party to settle the conflict. On occasion, two or more of these approaches are employed.

1. *Balancing the interests*

One approach to resolve a conflict of duty is to examine two interests, imagine placing them on a scale, and determine which is weightier. The determination may turn on a number of factors, including the principals' circumstances and the effects of a breach, but in any case the approach is subjective and depends on the weight the decision-maker assigns to the respective interests. One might assume, for example, that if a court were to weigh the interest of a potentially innocent person from being wrongly convicted, on the one hand, and the interest of a deceased person in maintaining confidentiality, on the other, the scale would tilt in favor of the potentially innocent defendant. But that is not the case.

Sarbanes-Oxley Misses the Point, 9 STAN. J.L. BUS. & FIN. 297, 316-17 (2004) (stating that ethical issues exist for lawyers with regard to confidentiality, conflicts of interest, and independence).

29. See Investment Company Governance, Investment Company Act Release No. 26323, 69 Fed. Reg. 3472-01, 3473-01 (Jan. 15, 2004) (questioning whether it would be appropriate, in the context of mutual funds, to restrict the number of boards on which a director serves to reduce the dissemination of confidential information), available at <http://www.sec.gov/rules/proposed/ic-26323.htm>.

30. See John K. Wells, *Multiple Directorships: The Fiduciary Duties and Conflicts of Interest that Arise When One Individual Serves More Than One Corporation*, 33 J. MARSHALL L. REV. 561, 568-69 (2000) (explaining that directors of two corporations must consider what acts are in the best interest of both companies).

Some courts will go to great lengths to protect attorney-client confidentiality in the face of competing interests.³¹ In *Arizona v. Macumber*,³² the defendant was found guilty of murder and sentenced to life imprisonment. During his defense, Macumber's attorney sought to introduce evidence of a confession that another person, who in the meantime had died, had committed the same crime for which Macumber was being tried.³³ The trial court, however, refused to admit the evidence on the grounds that it was privileged.³⁴ Macumber appealed and the Arizona Supreme Court believed that the interests at stake had been weighed by the legislature, which determined that confidentiality was more important.³⁵ The court recognized that maintaining confidentiality would result in an injustice, but it believed the legislature considered this consequence when it balanced the interests.³⁶ In the end, the court reversed the conviction on other grounds,³⁷ but it opted to maintain the

31. See *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981) (claiming that the attorney-client privilege is the oldest of the privileges for confidential communications in the common law); CHARLES W. WOLFRAM, *MODERN LEGAL ETHICS* 242 (1986) (highlighting attorney-client confidentiality as a central tenet of the attorney-client relationship in common law countries and in every state in the United States); see also MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. 2 (2000) (justifying the privilege on numerous policy grounds, such as facilitating fact development in a dispute necessary for the proper representation of the client and encouraging otherwise reticent clients to seek legal advice); Susan R. Martyn, *In Defense of Client-Lawyer Confidentiality . . . and its Exceptions*, 81 NEB. L. REV. 1320, 1323-30 (2003) (advancing utilitarian and deontological justifications for the privilege).

32. 544 P.2d 1084 (Ariz. 1976).

33. Macumber's attorney did not represent the deceased, and therefore, did not face a direct conflict between maintaining the confidentiality of the deceased and acting on behalf of his client. *Id.* at 1086. The deceased instead had been represented previously by two attorneys who were present for Macumber's trial. *Id.* The attorneys were willing to testify for Macumber that their client previously had confessed to the murders for which Macumber was accused. *Id.*

34. See *id.* (holding that only the client, or an authorized person of the client, may claim the privilege, and that another person may assert the privilege only where the privileged person is absent).

35. *Id.* The court first established that absent a waiver, an attorney may not be examined about any attorney-client communication, even if the client is deceased. *Id.* Next, the court held that under the circumstances of this case, waiver by the client's attorney was insufficient. *Id.* It is still the case that the attorney-client privilege survives the death of the client. While in some cases a personal representative, such as an executor, may waive the privilege on behalf of the client, those cases are generally limited to circumstances to benefit the estate and where the client, if alive, would readily consent to waiver. See *Mayorga v. Tate*, 752 N.Y.S.2d 353, 353-56 (App. Div. 2002) (noting that the right to waive one's interest in a deceased client's estate survives the death of the client, and may be exercised by the decedent's personal representative, in much the same way that the attorney-client privilege survives the death of the client for whose benefit the privilege exists).

36. *Macumber*, 544 P.2d at 1086.

37. See *id.* (holding that the trial court erroneously excluded expert testimony offered by defendant).

confidentiality of the dead client and bar the evidence of the confession.

In the famous case of *Tarasoff v. Regents of the University of California*,³⁸ the court took the same approach by employing a balancing test to justify disclosure. In that case, the court had to resolve a conflict between two legal duties owed by a therapist: the duty to a patient to maintain confidentiality and the duty to a potential victim to prevent harm.³⁹ The court recognized the public interest in safeguarding confidential communications between a psychotherapist and patient, but it stated, "Against this interest, however, we must weigh the public interest in safety from violent assault. The Legislature has undertaken the difficult task of balancing the countervailing concerns."⁴⁰ The court ruled that confidentiality had to yield to the extent that that disclosure was necessary to avert danger to others.⁴¹ While *Tarasoff* is not strictly a conflict of fiduciary duties, it illustrates the use of a balancing test to decide difficult cases.

Determining which interest is weightier is subjective. Soft interests such as preserving confidentiality or preventing injustice are not readily quantifiable. Assigning weights to such interests is tantamount to adopting a conclusion during what is supposed to be a process for reaching one. In fact, Justice Holohan in *Macumber* believed that the scales tilted in favor of breaching confidentiality in furtherance of Macumber's defense. Justice Holohan also claimed to weigh the competing interests, but he determined that the interest in presenting a defense outweighed the interest in confidentiality. He argued that "[t]he problem of balancing competing interests, privilege versus a proper defense, is a difficult one, but the balance always weighs in favor of achieving a fair determination of the cause."⁴² Justice Holohan stated that a claim of privilege "may have to give way when faced with the necessity of the accused to present a defense."⁴³

The approaches of both the majority and concurring opinions in *Macumber* are unappealing. If applied generally, Holohan's approach would create significant exceptions to the attorney-client privilege because an attorney could always claim that disclosure of one client's confidentiality was necessary to achieve a "fair determination of the

38. 551 P.2d 334 (Cal. 1976).

39. *Id.* at 345-46.

40. *Id.* at 346.

41. *Id.* at 347.

42. *Macumber*, 544 P.2d at 1088 (Holohan, J., concurring).

43. *Id.*

cause.” But while Holohan’s approach is not satisfactory, one has a negative reaction to the majority opinion as well. It seems preposterous that the statement of the deceased should be excluded and that, as a result, Macumber could have been convicted of crimes he did not commit. Like the innocent priest in Alfred Hitchcock’s “I Confess,” who faced conviction because he was unwilling to break the seal of confession,⁴⁴ in *Macumber*, a potentially innocent defendant faced conviction as well.

2. *Applying a property theory*

In weighing the interests in *Macumber*, Justice Holohan also invoked a property theory. Holohan stated that once the client had died, he could not be prosecuted for other crimes, and any privilege was “merely a matter of property interest.”⁴⁵ He went on to say that opposed to the property interest is the “vital interest” of the accused in defending himself. Holohan argued that “the constitutional right of the accused to present a defense should prevail over the property interest of a deceased client in keeping his disclosures private.”⁴⁶ Invoking a property theory, however, suffers from several infirmities in this context. First, it is unclear why the property interest articulated by Justice Holohan should be any less important than a constitutional interest. The United States Constitution places a value on property as well. The just compensation clause of the Fifth Amendment is evidence of that valuation,⁴⁷ as is the contracts clause in Article I, Section 10.⁴⁸ Second, determining when a property interest exists, like a balancing test, is subjective and conclusory. Labeling an interest “property” is a legal conclusion, not a basis for the conclusion. While familiar to judges and lawyers steeped in the common law, property is simply a term used to represent a set of interests that merit protection.⁴⁹

44. I CONFESS (Alfred Hitchcock 1953).

45. *Macumber*, 544 P.2d at 1088.

46. *Id.*; see Roberta Romano, *Comment on Easterbrook and Fischel, “Contract and Fiduciary Duty,”* 36 J.L. & ECON. 447, 448-49 (1993) (discussing a property theory of fiduciary duties).

47. See U.S. CONST. amend. V.

48. See U.S. CONST. art. I, § 10; LAURENCE TRIBE, *CONSTITUTIONAL CHOICES* 10-11 (1985) (noting a constitutional commitment to the institution of property and its contractual expectations); see also *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 94 F.3d 996, 1000 (5th Cir. 1996) (declaring that property is defined by state law and protected against the government by the Constitution); CHRISTOPHER M. DUNCAN, *THE ANTI-FEDERALISTS AND EARLY AMERICAN POLITICAL THOUGHT* 44 (1995) (stating that historically property merited protection as a means by which an individual entered the public realm and as a source of independence and citizenship).

49. See *RESTATEMENT OF PROP.* Ch. 1, introductory note (1936) (giving an even

Not surprisingly, therefore, the presence of a property interest does not lead to a particular conclusion and can be used to justify different results in a single case. A court can view property as the less important interest compared to other values such as justice or fairness. If that is the case, once a court designates a property interest, it can rule, as Justice Holohan did in the *Macumber* case, that the interest in “mere property” ought to be ignored. Alternatively, if a property interest is viewed as more important than other considerations, the presence or absence of property will cause a court to rule for or against a party. This was the result in *Siskind v. Sperry Retirement Program*,⁵⁰ which involved dual fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA).⁵¹ In that case, plan trustees for the Sperry Retirement Program also were corporate officers and excluded plan participants from an early retirement incentive program in the course of a merger.⁵² The court stated that the employees had no “property right” in the plan and their fiduciary duties were not violated.⁵³ Other than referring to the employer’s discretion in creating additional benefits under the plan, however, the court did not explain why no property right existed, or why the employer’s discretion was determinative.

Conflicts of duty over whether to disclose confidential information may also be resolved by deeming the information property worthy of protection. The Supreme Court, in an insider trading case, held that confidential information is a “species of property.”⁵⁴ This theory was determinative in settling a conflict of duty in *Cotton v. Merrill, Lynch, Pierce, Fenner & Smith*.⁵⁵ In that case, a financial firm, through an investment banking relationship, received positive confidential information about a company, but failed to disclose the information

broader definition to the term property to include “legal relations between persons” with respect to tangible and intangible things); 73 C.J.S. *Property* § 4 (1983) (stating, “In legal usage the word ‘property’ . . . may signify either the subjective matter in which rights or interests exist, or it may signify valuable rights and interests protected by law, or it may signify both”); see also *Metro. Opera Ass’n, Inc. v. Wagner-Nichols Recorder Corp.*, 101 N.Y.S.2d 483, 493 (1950) (explaining that “property rights” should be thought of as legal conclusions because they are protected from the intrusion of others by the courts); Gareth Jones, *Unjust Enrichment and the Fiduciary’s Duty of Loyalty*, 84 LAW Q. REV. 472, 485 (1968) (analyzing *Phipps v. Boardman*, 2 A.C. 46 (H.L. 1967), and stating that distinguishing between “property” and “equitable property” does not solve the question of whether the parties were unjustly enriched).

50. 47 F.3d 498 (2d Cir. 1995).

51. 29 U.S.C.A. §§ 1001-1461 (2004).

52. *Siskind*, 47 F.3d at 507.

53. *Id.*

54. See *Carpenter v. United States*, 484 U.S. 19, 26 (1987) (holding that confidential information acquired or compiled by a corporation is a species of property to which the corporation has the exclusive right and benefit).

55. 699 F. Supp. 251 (N.D. Okla. 1988).

to investors before they sold their shares.⁵⁶ The court held that the plaintiffs could not prove the firm breached a duty, stating that the confidential information was the firm's property and could not be shared.⁵⁷ But calling the interest property and worthy of protection does not address why the investor-clients of the firm should be denied access to the information to which they believed they were entitled. Why was the firm not depriving the investors of their property interest as well?

3. *Determining the actio libera in causa*

A third approach used to resolve a conflict of duties is to examine whether the fiduciary, attempting to escape blame for a breach of duty, inappropriately created the situation giving rise to a conflict. If the fiduciary claims that there was no choice but to engage in what is normally culpable conduct, a court may reject the claim if the fiduciary caused the conditions of this defense. A common illustration of causing the condition of one's own defense is the intoxicated actor who commits a crime. The defendant argues that the crime occurred while the defendant was intoxicated, and therefore, the defendant's mental state is similar to that of a person who is insane or incompetent. The difference, of course, is that the intoxicated actor is responsible for being intoxicated or, in other words, responsible for being inculpable.⁵⁸ The action (in this case

56. *Id.* at 256.

57. *Id.* (quoting *Carpenter*, 484 U.S. at 26). The case was brought as a private action alleging that Merrill Lynch handled the sale of the plaintiffs' stock in a company called United Energy Resources shortly before United Energy merged with Midcon Corporation, which caused the share price to rise. *Id.* at 253. The decision does not specify whether the trades were solicited or unsolicited, although use of the phrase "handled the sale" suggests that the transactions were not solicited. *Id.* The plaintiffs alleged that Merrill Lynch knew about the pending merger because it was also a financial advisor to both United Energy and Midcon, but failed to disclose to the plaintiffs material information about the merger. *Id.* The plaintiffs alleged that Merrill breached its fiduciary duty by defrauding the investors with respect to their sale of United Energy stock. *Id.* The court stated that "courts have established that brokers have a primary obligation not to reveal inside information to clients for the clients' benefit in trading securities." *Id.* at 256. The court concluded that even if it assumed the existence of "conflicting fiduciary obligations, there can be no doubt which is primary here." *Id.* (quoting *In re Cady, Roberts & Co.*, Exchange Act Release No. 6668, 40 SEC Docket 907, 916 (Nov. 8, 1961)). The presence of a property interest assumes additional importance where one can claim—as the court did here—that disclosure could lead to prosecution for depriving others of their property. *Id.*

58. See, e.g., Paul H. Robinson, *Causing the Conditions of One's Own Defense*, 71 VA. L. REV. 1, 7-8 (1985) (noting that most jurisdictions do not allow an intoxication defense when the defendant chose to become intoxicated); cf. Dr. Heinz-Dietrich, *Epilepsy Its Place as a Legal Defense*, 16 MED. & L. 413, 416 (1997) (explaining that an epileptic who suffers an epileptic attack while driving and causes harm may defend losing control of the vehicle so long as the epileptic was not aware of the condition

committing a crime) was free in its origin or free in its cause—*actio libera in causa*—and therefore culpable, even if not free in its execution.⁵⁹

It is easy to see the role this doctrine can play in conflict of duty cases. A fiduciary, who creates a situation where a conflict has arisen, may seek to avoid culpability for a breach of duty to one principal by arguing that there was no choice but to breach the duty. One could argue, however, that the fiduciary is blameworthy for creating the situation in the first place. Thus, one way to resolve a conflict of duty is to bar a defense to a breach of duty claim if the defense is based on actions taken at an earlier time that could have been avoided. The actor will not be permitted to defend an allegedly culpable act by arguing that a breach of duty to one of the principals was inevitable.

Courts seem to take this approach in a line of cases involving financial firms. In the California case *Black v. Shearson, Hammill & Company*,⁶⁰ the issue was whether a brokerage firm that had material negative non-public information about a company, because a member of the firm sat on the company's board, was required to disclose the information to brokerage customers investing in the company's shares.⁶¹ The firm argued it should not be liable for non-disclosure because it had a fiduciary duty to the company client not to reveal confidential information.⁶² The court ruled that it lacked sufficient reason "for permitting a person to avoid one fiduciary

before the attack occurred).

59. See Leo Katz, *Before and After: Temporal Anomalies in Legal Doctrine*, 151 U. PA. L. REV. 863, 880-81 (2003) (explicating the problem in a criminal law context where prohibitions require a specific intent and posing a paradoxical example where an actor may be able to bring about his desired end but avoid the prerequisites for liability); see also LEO KATZ, *ILL-GOTTEN GAINS: EVASION, BLACKMAIL, FRAUD, AND KINDRED PUZZLES OF THE LAW* 30-32 (1996) (analogizing the problem with a person who buys a painting he dislikes just so he may destroy it).

60. 72 Cal. Rptr. 157 (Ct. App. 1968).

61. The brokerage firm, Shearson, had a partner named Dunbar, who also was a director of United States Automatic Merchandising Company (USAMCO). *Id.* at 158. As part of its efforts to sell USAMCO shares, Shearson distributed press releases and reports containing positive representations about the company's operations. *Id.* at 159. Some investors even were told that Dunbar's service on USAMCO's board put Shearson in a position to receive inside information. *Id.* Since Dunbar failed to disclose negative information to Shearson personnel, Shearson's brokers continued to reiterate positive representations to its customers even after the situation at USAMCO was bleak. *Id.*

62. "The essence of the argument is that, as between [the member's] conflicting duties, the duty of confidentiality he owed to [the company] as a director was higher than the duty he owed to Shearson's customers as their broker." *Id.* at 161. In support of its argument, Shearson cited, and the court considered, a New York Stock Exchange Educational Circular, which exhorted those in Dunbar's position to "meticulously avoid any disclosure of inside information to his partners, employees of the firm, his customers or his research or trading departments." *Id.* (citing NEW YORK STOCK EXCHANGE EDUCATIONAL CIRCULAR NO. 162 (June 22, 1962)).

obligation by accepting another which conflicts with it.”⁶³ The court continued, “The officer-director’s conflict in duties is the classic problem encountered by one who serves two masters. It should not be resolved by weighing the conflicting duties; it should be avoided in advance . . . or terminated when it appears.”⁶⁴ The firm, in other words, should not have put itself in the position where its member was able to obtain confidential information at the same time it was recommending purchase of the company’s shares to brokerage customers. This parallels a case in which a firm solicited customers to purchase a company’s shares after the firm received adverse information about the company. The district court held that the firm could not place itself in a conflict situation and then disregard its duty to one client:

Shearson voluntarily entered into a fiduciary relationship with Tidal Marine, as a consequence of which it received confidential information. Shearson also voluntarily entered into fiduciary relationships with its customers. It cannot recognize its duty to the former while ignoring its obligation to the latter. Having assumed fiduciary responsibilities, Shearson is required to incur whatever commercial disadvantage fulfillment of those obligations entails.⁶⁵

While this approach to resolving conflicts of duty is appealing, it is not sufficiently robust to address many types of cases. It is often difficult or impossible to claim that the actor should not have placed himself in a situation where a conflict might arise. In *Arizona v. Macumber*,⁶⁶ for example, the attorneys for the deceased obtained confidential information from their client as part of performing their duty. They could not have known at the time that the same information would assist in another’s defense, and even if they knew, they could not disregard their client’s statement.

Another difficulty with this approach is determining at which point the actor is at fault in not foreseeing a potential conflict. The process of creating the conditions that lead one to undertake the allegedly illegal action can entail several events, and the problem lies in determining for which event the actor is culpable.⁶⁷ In *Black*, should one ask whether the individual firm member should have sat on the

63. *Id.*

64. *Id.*

65. *Slade v. Shearson, Hammill & Co.*, [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,329 (S.D.N.Y. Jan. 2, 1974).

66. 544 P.2d 1084, 1086 (Ariz. 1976).

67. See Robinson, *supra* note 58, at 9 (illustrating the difficulties in this problem with an example of an actor who has a defective muffler which throws off a spark and starts a forest fire).

issuer's board, whether the firm should have solicited the purchase of the company's shares while he was on its board, whether the firm should have made representations about the company while he was on the board, whether the individual himself should have made such representations, or whether he should have corrected his earlier representations if he subsequently learned that they were false?

4. *Determining which interest was present first*

In many cases, applying the doctrine of *actio libera in causa* does not work well because it is difficult to argue that actors are responsible for causing the conditions of their own defense. Another approach attempts to determine which of the two competing interests arose first. The idea here is that when a fiduciary agrees to act on behalf of a principal, the fiduciary agrees to put the interests of that principal first—"first in time, first in right."⁶⁸ And the principal may not have entered the relationship if he knew that the fiduciary would have a conflict with respect to other principals. Thus, resolving conflicts in this manner is often accomplished by requiring consent by the first principal before a fiduciary can act on behalf of a second. The Second Restatement of Agency provides, "Unless otherwise agreed, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons whose interests conflict with those of the principal in matters in which the agent is employed."⁶⁹ The same is true for attorneys. When addressing conflicts of duty between and among multiple clients, the general rule according to the Third Restatement of the Law Governing Lawyers is that conflicts are prohibited unless all affected clients consent.⁷⁰

The "first in time, first in right" rule has been applied to a company director who is subsequently named a trustee where the trust holds shares of the company. In *Rosencrans v. Fry*,⁷¹ the court resolved this conflict by requiring the trustee to continue to satisfy the interests of the company's shareholders before satisfying the interests of the beneficiaries. In that case, a company officer (Fry), became a trustee for a testamentary trust that held the company's shares.⁷² One of the

68. *Cf.* *United States v. City of New Britain*, 347 U.S. 81, 85 (1954) (explaining that for statutory liens, this widely-accepted principle grants satisfaction first to prior claims) (citing *Ranking v. Scott*, 25 U.S. 177, 179 (1827)).

69. RESTATEMENT (SECOND) OF THE LAW OF AGENCY § 394 (1958).

70. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 (2000).

71. 91 A.2d 162 (N.J. Super. Ct. Ch. Div. 1952), *aff'd*, 95 A.2d 905 (N.J. 1953).

72. The case concerned one-half of the estate of Charles Rosencrans, bequeathed to his wife Lee and to William Fry, in trust for the benefit of Lee and Rosencrans's two nephews. *Id.* at 163-64. This portion of the estate included all of Rosencrans's stock in a company that he organized. *Id.* at 164. Fry managed the

beneficiaries (Lee Rosencrans, the testator's wife) claimed that Fry should have caused the company to declare greater dividends between the time of the testator's death and the time that Fry, pursuant to an option provided by the will, purchased the shares.⁷³ Fry's failure to cause the company to declare greater dividends, Lee claimed, constituted a breach of duty as trustee.⁷⁴ The court noted, "It is obvious that the duty as director and the duty as trustee might in some cases lead in different directions. They must be composed upon some rational basis."⁷⁵ In resolving the case in Fry's favor, the court pointed out that Lee and Fry were on the board of directors and had approved dividends and other company policies.⁷⁶ She objected only after Fry sought to purchase the shares pursuant to his option.⁷⁷ The court noted that long before Fry became a trustee, the company did not distribute all of its earnings to shareholders—it retained earnings for business purposes.⁷⁸ The testator, therefore, must have contemplated that some of the earnings would be retained for operations and expansion, and both Lee and Fry agreed early on that the company should continue to expand.⁷⁹

The court recognized that in voting shares of stock, trustees typically have a duty to promote the interests of the beneficiaries.⁸⁰ But this doctrine, the court said, "does not embrace a duty to advance the interest of the beneficiary at the expense of the corporation and other outstanding stockholders' interests."⁸¹ The court, however,

company and sat on the board of directors. *Id.* at 166. In his will, Rosencrans also gave Fry the right to purchase the shares in the trust corpus for twenty-five dollars per share. *Id.* at 163. Much of the litigation surrounded the right of Fry to purchase the shares, but the court also addressed Lee's claim that Fry should have been required to account to her for earnings of the company that accrued between the date of Rosencrans's death and the date Fry exercised his right to purchase. *Id.* at 165. For a discussion of this case, see Frank T. Becker, *Control of Trust-Held Companies*, 19 J. CORP. L. 41, 53-55 (1993) and Note, *The Trust Corporation: Dual Fiduciary Duties and the Conflict of Institutions*, 109 U. PA. L. REV. 713, 720-21 (1961).

73. *Rosencrans*, 91 A.2d at 164.

74. The court recognized the difficult spot in which the trustee found himself. *Id.* at 165. The court stated that Fry "was also a director of the company and was saddled with the duties of that office. It is impossible to evaluate the performance of his duty as trustee under the will without taking into account the propriety of his performance as director of the company." *Id.* at 165-66. The court expressed that the difficulty in the case arose not because the trustee placed himself in a conflict situation, but rather, from a potential conflict "which the testator himself created." *Id.* at 166.

75. *Id.*

76. *Id.*

77. *Id.* at 166-67.

78. *Id.* at 167.

79. *Id.*

80. *Id.*

81. *Id.* at 168.

sidestepped the issue of determining which interest should prevail.⁸² The court could have concluded that a trustee's duty to a beneficiary prevails over a company director's duty to shareholders. Ample authority supports the proposition that the duty of a trustee to the beneficiaries of a trust is more important than the duty of a company director to the shareholders.⁸³ Instead of ruling in the beneficiary's favor, the court seemed to think that the trustee could act with "fairness" in discharging his duties to both principals, but it is hard to understand what fairness means in this context and why the meager dividends declared during the relevant period were fair to the beneficiaries.

In addition to the unanswered questions raised in this case, attempting to determine which interest was present first would not help resolve many other cases. While it might explain *Arizona v. Macumber*,⁸⁴ where the duty of confidentiality to the deceased client arose long before the duty to provide a defense to Macumber, it would not assist in resolving the conflicts that arose in *Black v. Shearson, Hammill & Company*⁸⁵ and *Cotton v. Merrill, Lynch, Pierce, Fenner & Smith*.⁸⁶ In those cases, emphasizing the timing of when a duty arose introduces arbitrariness into the cases that makes application of the principle unworkable. Some brokerage or advisory clients may have established their relationship with the financial firm before it received confidential information and some after. This would lead to the untenable situation where the firm would resolve conflicts with clients differently depending on when a particular relationship arose. Not only would this be difficult to administer, it would result in similar clients being treated differently based on the arbitrary distinction of when their relationship with the firm commenced.

5. *Seeking the view of a neutral third party*

A fifth approach employed by courts to resolve conflicts of duty is to remove the yoke of decision from the parties and place it on a

82. See Becker, *supra* note 72, at 53 (noting that the court in *Rosencrans* did not give specific guidelines for trustee-managers to resolve potential conflicts of interest).

83. See, e.g., *Prueter v. Bork*, 435 N.E.2d 109, 111 (Ill. App. Ct. 1981) (asserting that the duty of loyalty owed to a beneficiary by a trustee is the most important of any fiduciary relationship); RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b (1959) ("The duties of a trustee are more intensive than the duties of some other fiduciaries."); SCOTT & FRACHTER, *supra* note 12, at § 170 ("In some relations the fiduciary element is more intense than others; it is peculiarly intense in the case of a trust.").

84. 544 P.2d 1084 (Ariz. 1976).

85. 72 Cal. Rptr. 157 (Ct. App. 1968).

86. 699 F. Supp. 251 (N.D. Okla. 1988).

neutral third party with the information and distance to decide the conflict objectively. Courts adopting this approach display a paternalistic view that parties faced with a conflict are incapable of resolving it on their own and should turn instead to the court or some other third party for guidance. This sentiment is illustrated in *Shanley's Estate v. Fidelity Union Trust Company*.⁸⁷ In that case, a testamentary trust included stock of a subsidiary company, and certain directors of the subsidiary's parent were also directors of the trustee company.⁸⁸ The parent sought to merge with the subsidiary, and it offered to purchase the shares of the subsidiary from the trust.⁸⁹ The trust beneficiaries objected to the sale, but several directors of the trust company, who also were directors of the parent, supported it.⁹⁰ The directors who served on both the board of the trust company and the board of the parent were presented with a conflict. They owed a duty to the parent to purchase shares of the subsidiary, held by the trust, on the most favorable terms possible; they also owed a duty to the heirs to refrain from selling the shares because the heirs opposed the sale.⁹¹ The court stated, "The directors of our trustee are in conscience bound to consider only the welfare of our wards and strive for the best price obtainable; as directors of the [parent], their duty is no less to secure the most favorable terms. The true balance is infinite."⁹² The opinion at least twice suggested the parties contact the court for advice. The court noted, "In the dilemma in which it found itself, the course open to our trustee was to apply to the court for instructions, not to compel our wards to appeal for protection."⁹³ The court did not permit the sale and concluded that the trustee "may shift the responsibility to the court by asking instructions."⁹⁴

While seeking outside advice may have provided for certainty in *Shanley's Estate*, applying such an approach across-the-board is impractical. First, in many cases, a fiduciary faced with a conflict of duty must make a quick decision—time is a luxury not afforded an attorney in the heat of trial or a financial adviser faced with dynamic market conditions. Second, requiring a fiduciary to seek the advice of a third party each time a conflict arose would be burdensome.

87. 138 A. 388 (N.J. Ch. 1927).

88. *Id.* at 388.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.* at 389.

While third parties such as ethics committees may establish hot-lines or other avenues to render informal advice, they likely do not anticipate being called upon to make decisions each and every time a conflict arises. Third, even if a third party renders a decision, there is no guarantee a court will agree.⁹⁵ Finally, seeking such prospective relief is generally inconsistent with our system of justice. Where parties disagree in retrospect, they call upon courts to decide their case, but courts typically do not make such decisions prospectively. It is the nature of the judicial process to settle disputes based on events that occurred in the past and establish general rules as instruments of social control, not to provide prospective advice to individual parties.⁹⁶

Each of the five approaches identified fails as a consistent means to address conflicts of duty and account for the outcomes in the cases. One approach is to weigh competing interests, but that approach is too subjective, and other courts specifically reject it.⁹⁷ Some courts look for a property interest, but that seems to sidestep the analysis that allows those courts to reach the conclusion that a property interest exists and merits protection. Still other courts seem to take the view that a fiduciary should not create a conflict situation and then seek to avoid blame for taking actions that might otherwise be viewed as culpable—actors may not cause the conditions of their own defense. But not all conflicts of duty arise as a result of poor foresight. Other approaches—first in time, first in right, and relying on a third party decision-maker—are inadequate. In order to determine how courts resolve conflicts of duty, I shall explore more deeply the *nature* of the duties that the fiduciary owes its principals. Only after distinguishing between the duties can one make sense of the courts' rulings.

II. LOYALTY AND CARE

Part I explored conflicts between duties owed to multiple principals and outlined various approaches to addressing those

95. See, e.g., *Arizona v. Macumber*, 544 P.2d 1084, 1087 (Ariz. 1976) (Holohan, J., concurring) (emphasizing that, although the parties in that case had sought and received an opinion from the Committee on Ethics of the State Bar about a legal issue, the court ignored the Committee's advice).

96. See H.L.A. HART, *THE CONCEPT OF LAW* 121 (1984) ("If it were not possible to communicate general standards of conduct, which multitudes of individuals could understand, without further direction, as requiring from them certain conduct when occasion arose, nothing that we now recognize as law could exist.").

97. See, e.g., *Black v. Shearson, Hammill & Co.*, 72 Cal. Rptr. 157, 161 (Ct. App. 1968) (rejecting a balancing test in favor of either avoiding the conflict in advance or terminating it once it appears).

conflicts. What makes these cases difficult is that the courts were faced with competing claims of a different nature—a claim by one principal not to be harmed by the fiduciary and a claim by another to be helped, but helping the second in each case entailed harming the first. This Part demonstrates that these two competing claims reflect a tension between satisfying the duty of loyalty and promoting the duty of care, duties that wind around each other like a double helix comprising the fiduciary obligation.⁹⁸ To illustrate this tension, this Part examines the character of the duties. Once the difference between the two duties is established, Part III shall discuss how courts apply these principles and enforce the duty of loyalty, even if it results in a breach of the duty of care.

A. *The Duty of Loyalty*

An agreement to enter into a fiduciary relationship generates the fiduciary's duty of loyalty.⁹⁹ One may begin, therefore, by considering what a relationship of loyalty entails. Consider the characteristics of a relationship that results from a promise to keep a secret. First, the promise implies negative action on the part of the promisor; the promisor agrees to refrain from acting against the other's wishes by refraining from disclosing a secret. Second, the promise represents an ongoing commitment; the promisor agrees to keep the secret not only for the time being but also for an extended, usually open-ended, period. Third, the promise requires (or may require) a sacrifice; one promises to keep a secret even at the risk of some hardship and only

98. See, e.g., *Air Line Pilots Ass'n Int'l v. O'Neill*, 499 U.S. 65, 75 (1991) (announcing that a fiduciary's duties consist of both a duty of care and a duty of loyalty); *Cent. States, Southeast & Southwest Areas Pension Fund v. Cent. Trans., Inc.*, 472 U.S. 559, 572 (1985) (stating that ERISA trustee's fiduciary standards of loyalty and care are borrowed from common law); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993) ("Duty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavors to act in the service of a corporation and its stockholders."); *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985) (categorizing the duty to exercise an informed business judgment as falling under the duty of care, rather than under the duty of loyalty); see also Langbein, *supra* note 1, at 655 (proclaiming, "The law of fiduciary administration . . . resolves into two great principles, the duties of loyalty and prudence."); E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 397 (1997) (charging directors, as fiduciaries, with the duties of loyalty and care to both the corporation and its stockholders).

99. The fiduciary's duty of loyalty is a legal duty. But one often uses the word "loyalty" to depict non-legal relationships, such as loyalty to one's school or one's colleague. In fact, to preserve relationships of loyalty, legal requirements are often set aside, such as the requirement to testify against a spouse, a client, or a patient. See GEORGE P. FLETCHER, *LOYALTY: AN ESSAY ON THE MORALITY OF RELATIONSHIPS* 47 (1993) (distinguishing criminality, where the law requires a link between the outward act and internal intention, and morality, where the importance lies in "whether the bond of love, friendship, or trust is breached or maintained.").

after placing one's own interests second (one who agrees to keep a secret only until doing so causes personal hardship is hardly considered loyal). Finally, a promise to keep a secret is unambiguous. While disclosure may be permitted in some cases, the nature of the undertaking is clear-cut and the relationship is tarnished or ends from an unauthorized disclosure. Each of these elements—an ongoing commitment not to act against another's interests, maintained at personal sacrifice, and unbending in nature—characterizes loyalty.

While a duty of loyalty often includes a commitment not to disclose the secrets of another, it means more in the fiduciary context. It also includes not making use of the principal's information or other resources for one's own advantage (or the advantage of a third person) because such use may harm the principal. Thus, the fiduciary may not take advantage of the principal—an important component of any relationship of loyalty.¹⁰⁰

1. *The nature of the duty of loyalty*

The negative component of the fiduciary duty is captured by the duty of loyalty. Under the heading, "Duty of Loyalty," the Second Restatement of Trusts states that the fiduciary "is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do so."¹⁰¹ Similarly, the Second Restatement of Agency provides that the duty of loyalty entails a duty not to make a profit on transactions conducted for the principal¹⁰² or deal with the principal as an adverse party.¹⁰³ In his celebrated treatise, John Norton Pomeroy wrote about the relationship between a trustee and a beneficiary, and divided the

100. See, e.g., *Demoulas v. Demoulas Super Mkts., Inc.*, 677 N.E.2d 159, 182 (Mass. 1997) (explaining that the duty of loyalty requires a corporate officer to disclose before taking advantage of a corporate opportunity or engaging in self-dealing); *Folkin v. Cole*, 548 N.E.2d 795, 808 (Ill. App. Ct. 1989) (suggesting that a director breaches his fiduciary duty to the corporation by taking advantage of a business opportunity belonging to the corporation). One is accustomed to thinking about loyalty as a relationship among three parties. A is said to be disloyal to B if A shares B's secrets with C, who is lurking in the background as a potential competitor to B. See FLETCHER, *supra* note 99, at 8 (insisting that three parties always exist in a loyalty dilemma). But a loyalty matrix can include two people when the self-interest of one of them puts the relationship in peril. Consider an example where A and B are supposedly in a loyal relationship and where A learns of a potential opportunity that could benefit either. A shares the information with B, and B, without telling A, selfishly seeks the opportunity. While it may be unclear whether B must promote A's obtaining the opportunity, loyalty at a minimum requires forbearance by B.

101. RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. a (1959).

102. RESTATEMENT (SECOND) OF AGENCY § 388 (1958).

103. *Id.* § 389.

discussion of the duty of loyalty (which he calls good faith) into four categories—all negative.¹⁰⁴ Leading cases in corporate law distinguish negative from positive duties,¹⁰⁵ and the duty of loyalty often is considered a duty against self-dealing.¹⁰⁶ A classic treatment of the corporate director's duty of loyalty provides, "The basic principle to be observed is that the director should not use his corporate position to make a personal profit or gain other personal advantage."¹⁰⁷ The same is true for lawyers. Under the rubric of duties of loyalty, the Third Restatement of the Law Governing Lawyers recognizes, "In general, they prohibit the lawyer from harming the client."¹⁰⁸ The Revised Uniform Partnership Act states that a partner's duty of loyalty is limited to prohibitions against theft, self-dealing, and competing against the partnership.¹⁰⁹

While the nature of the fiduciary duty of loyalty is clear—a negative duty not to harm the principal—enforcing the duty is difficult because the ability to control the affairs or assets of another presents subtle opportunities for cheating or stealing that are hard to monitor. Courts, therefore, impose prohibitions or prophylactic rules to ensure that the fiduciary is not tempted to act selfishly.¹¹⁰

104. See JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § VI, at §§ 1075-78 (Spencer W. Symons ed., 5th ed. 1941) (explaining that the duty of loyalty includes (1) the duty not to deal with trust property for one's own advantage; (2) the duty not to commingle trust funds; (3) the duty not to accept a position, enter into a relation, or do any act inconsistent with the interests of the beneficiary; and (4) the duty not to sell trust property to oneself).

105. See, e.g., *Ivanhoe Partners v. Newmont Mining Co.*, 535 A.2d 1334, 1345 (Del. 1987) (obligating directors, under the duty of loyalty, with an affirmative duty to protect corporate interests and also with a duty to avoid conduct injurious to the corporation); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (requiring more than the absence of fraud or bad faith in order to fulfill one's fiduciary duty); *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939) (describing the duty of officers and directors as "not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage").

106. See *Cameco, Inc. v. Geddicke*, 724 A.2d 783, 789 (N.J. 1999) (noting that an employee's self-dealing may breach the duty of loyalty owed to the employer).

107. *The Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1599 (1978). See generally Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 35-36, 75-76 (1966) (examining the history of legal rules regulating conflicts of interest and proposing legislative changes to improve their effectiveness).

108. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 cmt. e (2000) (proscribing the disclosure of sensitive information, lying, obtaining unfair contracts or gifts, sexual relations, abusing the client's dependence, and risking the lawyer's independent judgment).

109. REVISED UNIFORM PARTNERSHIP ACT § 404(b) (1994); see Donald Weidner, *The Revised Uniform Partnership Act Midstream: Major Policy Decisions*, 21 U. TOL. L. REV. 825, 857 (1990) (explaining that these duties are purportedly exclusive).

110. See *SEC v. Chenery*, 318 U.S. 80, 92 (1942) ("Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction."); Frankel, *supra* note 1, at 1217-18 (elaborating on the high

Common law antecedents of such prophylactic rules date at least to the leading English case of *Keech v. Sandford*.¹¹¹ In that case, a trustee held a lease for the benefit of an infant.¹¹² When the lease was about to expire, the trustee attempted to renew it for the infant but the owner refused, so the trustee leased the property for himself.¹¹³ The chancery court, concerned with prohibiting a trustee from taking for himself a benefit belonging to the beneficiary, ruled that the trustee must hold the lease for the benefit of the infant: “This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that [the] rule should be strictly pursued, and not in the least relaxed”¹¹⁴

Under the rule of *Keech*, the duty of loyalty represents a constraint—a legal disability—to which the fiduciary must adhere.¹¹⁵ Early United States courts followed this rule. In 1816, in *Davoue v. Fanning*,¹¹⁶ the New York Court of Chancery set aside a sale of real estate at a public auction by an executor acting as trustee when the buyer was the executor’s wife. The chancellor said it was a “sound and settled doctrine” that a trustee may not have an interest in the sale of trust assets.¹¹⁷ Similarly, in 1846, in *Michoud v. Girod*,¹¹⁸ the Supreme Court overturned a purchase of property by two executors of a will, sold at public auction, even though the executors paid a fair price. The executors were prohibited from considering on a case-by-

cost of detecting fiduciaries’ misappropriation and fiduciaries’ temptations to steal); Langbein, *supra* note 1, at 640 (providing that the law previously addressed opportunism on the part of trustees by limiting their power, but this has been replaced by a new set of rules under the rubric of fiduciary administration).

111. 25 Eng. Rep. 223 (P.C. 1726). For a discussion of this case, see Jones, *supra* note 49, at 474. Establishing prophylactic rules to guard against temptation may be traced to the Old Testament. In *Genesis*, God commanded that Adam not eat from the Tree of Knowledge. *Genesis* 2:17. When Eve repeated the command to the serpent, she embellished it, instead stating that God had said to Eve, “Ye shall not eat of it, neither shall ye touch it” *Genesis* 3:3. In Rashi’s commentary on this passage, he explains that Eve added to God’s command, which did not forbid touching the tree but only eating its fruit, “therefore she was led to diminish from it.” PENTATEUCH AND RASHI’S COMMENTARY 13 (Dr. A.M. Silberman ed., 1946).

112. *Keech*, 25 Eng. Rep. at 223.

113. *Id.*

114. *Id.*

115. See Jones, *supra* note 49, at 474 (“The courts attempt to prevent any breach of loyalty by imposing upon a fiduciary the most severe duty of loyalty; he must be safeguarded from any unhealthy temptation and deterred from the mere contemplation of profiting from his fiduciary position.”).

116. 2 Johns Ch. 252 (N.Y. Ch. 1816).

117. *Id.* at 257. The court’s opinion has moral overtones. The court observed that the doctrine is established “to remove the trustee from temptation” and that the remedy established “goes deep and touches the very root of evil.” *Id.* at 261.

118. 45 U.S. 503 (1846).

case basis whether a transaction with the testator may be permissible; instead they were barred from transacting altogether:

The disability to purchase is a consequence of that relation between them which imposes on the one a duty to protect the interest of the other, from the faithful discharge of which duty his own personal interest may withdraw him. In this conflict of interest, the law wisely interposes. It acts not on the possibility, that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty. It therefore prohibits a party from purchasing on his own account that which his duty or trust requires him to sell on account of another, and from purchasing on account of another that which he sells on his own account.¹¹⁹

More recently, the Supreme Court recognized that the need for prophylactic rules arises not only from conscious temptations to act in one's self-interest, but also by a tendency to act in accordance with unconscious bias.¹²⁰

Even if a transaction between a fiduciary and a principal exhibits a fair price, the transaction is prohibited. This prohibition is the classic effect of a prophylactic rule: certain transactions not of the type a rule was designed to prevent are nevertheless barred. If a transaction exhibiting a fair price is prohibited, what about a transaction that results in a benefit to the principal? In that case, the prophylactic rule would diminish the beneficiary's well-being. The Supreme Court addressed this situation in *Magruder v. Drury*.¹²¹ Real estate brokers named Arms & Drury transacted with a trust to which the same Drury

119. *Id.* at 554-55.

120. See *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 191-92 (1963) (stating that the protections Congress created for the fiduciary clients of investment advisers were intended to eliminate or expose unconscious as well as conscious bias). Recent research suggests that decisions based on unconscious bias are common. We make unconscious decisions to further our own self-interest even when we know we should avoid doing so. According to this research, our desires influence the way we process information, even if we are trying to be objective. See Max H. Bazerman et al., *Why Good Accountants Do Bad Audits*, HARV. BUS. REV. Nov. 2002, at 97, 98 (noting, "When we are motivated to reach a particular result, we usually do."). For example, well over half of survey respondents typically rate themselves above average in the areas of ethics, productivity, health, managerial ability, driving ability, and other skills. Linda Babcock & George Lowenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. ECON. PERSP. 109, 111 (1997). Other research suggests that mere disclosure by a fiduciary of a conflict of interest may make matters worse. Disclosure of a conflict may inadvertently give the fiduciary implicit license to harm the principal more than if the disclosure had not been made, while failing to equip the principal with the necessary means to take the conflict of interest into account. Bazerman et al., *supra* note 120, at 101.

121. 235 U.S. 106 (1914).

acted as trustee.¹²² The transactions were conducted in the regular course of business, and on terms that cost the estate “not a penny more” than any other firm.¹²³ The Court noted that the relationship between the firm and the trustees actually benefited the estate by enabling the trustees to immediately reinvest trust assets with no loss of income.¹²⁴ Nevertheless, the Court insisted on applying a prophylactic rule:

It is a well-settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity.¹²⁵

Modern fiduciary law reflects the rule of *Michoud* and *Magruder*. It prohibits transactions between a fiduciary and his principal, even if the transaction would put the principal in a better position than he would have been in had the transaction not occurred.¹²⁶

122. *Id.* at 118.

123. *Id.*

124. *Id.* at 119.

125. *Id.*; cf. *Ostic v. Mackmiller*, 207 P.2d 1008, 1010-11 (N.M. 1949) (recognizing that transactions between guardians and wards, through which the guardian obtains a benefit, are presumptively invalid).

126. See, e.g., *Marsh v. Gentry*, 642 S.W.2d 574 (Ky. 1982) (refusing to uphold a transaction between a fiduciary and a principal, even though the principal arguably would have profited \$75,000 from the transaction). In that case, John Marsh and Tom Gentry formed a partnership to buy and sell horses for profit. *Id.* at 575. The partnership owned a mare named Champagne Woman and a foal of Champagne Woman named Excitable Lady. *Id.* The partnership consigned Champagne Woman for sale. *Id.* Then, without telling Marsh, Gentry, through a third person, bid on Champagne Woman and purchased her for \$135,000. *Id.* The partnership put Excitable Lady up for sale and Gentry purchased her through a third person as well. *Id.*

The court stated that partners must act with a high degree of good faith and disallowed the transactions. *Id.* at 576. The relevant Kentucky statute provided that a partner must account for and hold as trustee any benefit derived from a transaction connected with the partnership, if the benefit was derived without the consent of the other partners. *Id.* at 575. The court de-emphasized the pecuniary gain that could have resulted to the partnership and emphasized the secret undisclosed nature of the transactions. *Id.* at 576. The court recognized that Marsh obtained the stipulated purchase price but stated that “a partner has an absolute right to know when his partner is the purchaser.” *Id.* Partners scrutinize buy-outs by other partners, the court stated, differently than ordinary third party sales, and Marsh said he would not have consented to the sale had he known Gentry was the buyer. *Id.*

The dissent made plain that the partnership would have been better off as a result of Gentry's purchase. *Id.* at 578. The bidding for Champagne Woman faltered at \$60,000 when Gentry's agent stepped in and bid \$135,000. *Id.* The dissent stated, “Marsh was considerably better off financially with Gentry being the purchaser rather than if the horse had been sold off at \$60,000.” *Id.*

While most rules designed to ensure that the fiduciary is not tempted to engage in self-dealing are negative, the common law duty of loyalty also embodies certain subsidiary obligations that can be considered positive. Thus, not all fiduciary duties of loyalty are strictly negative.

Perhaps the most common positive duty designed to promote the duty of loyalty is a trustee's obligation to earmark and segregate trust property. A trustee must hold trust property in his representative capacity, not in his own name.¹²⁷ The Second Restatement of Trusts provides that the trustee has a duty to keep the trust property separate from personal property and other property not subject to the trust, and to ensure that the property is designated as trust property.¹²⁸ George Taylor Bogert explained that the reason for the rule is, "If a trustee is permitted to hold the trust res just as he holds his individual property, he may be subjected to a strong temptation to take the trust property for himself and allocate to the trust one of his own less advantageous pieces of property."¹²⁹ A simple example arises when a trustee holds both trust cash and personal cash, and the personal cash is stolen. Under these circumstances, the trustee may be tempted to protect the personal cash by claiming that the trust cash was taken.¹³⁰ "Men in extremity have been known to reach across every barrier of trust to take any monies or securities which could be converted to their salvation."¹³¹

One could, of course, reformulate the requirements to earmark and segregate trust assets as a negative duty not to mingle trust funds with personal funds, and the Restatement's comments support this view.¹³² But fundamentally, the requirements to earmark and segregate are positive; they entail particularized actions the fiduciary must take. A more difficult question is why duties to earmark and

127. See BOGERT, *supra* note 13, at § 596 (explaining that the trustee's duty to earmark requires him to hold trust property and assets in his capacity as trustee and not without mention of the trust); see also *Lawyers Sur. Corp. v. Whitehead*, 719 So. 2d 824, 830 (Ala. Civ. App. 1997) (noting that Alabama imposes absolute liability on trustees for losses incurred by an investment when title is taken in the trustee's personal capacity).

128. RESTATEMENT (SECOND) OF TRUSTS § 179 (1957).

129. BOGERT, *supra* note 13, at § 596.

130. *Id.*; see also *In re Union Trust Co. of N.Y.*, 149 N.Y.S. 324, 329 (Sur. Ct. 1914) (explaining that trustees cannot be trusted to hold trust property in their own name, as they would be tempted to use such property for their own profit).

131. *In re Union Trust Co. of N.Y.*, 149 N.Y.S. at 329.

132. See RESTATEMENT (SECOND) OF TRUSTS § 179 cmt. b (1957) (insisting that it is the duty of a trustee to keep trust funds separate from personal funds); *id.* § 179 cmt. c (maintaining that it is the duty of the trustee to refrain from mingling property held in different trusts); see also *In re Union Trust*, 149 N.Y.S. at 329 (holding that a trustee may not mingle trust property with his own property or other trust property).

segregate are not treated under the duty of care as positive duties, discussed below, as opposed to the duty of loyalty. Indeed, in some contexts, such duties have been labeled a part of a fiduciary's exercise of due care.¹³³ While one could place the requirements to earmark and segregate under the rubric of due care, the rationale for the duties—avoiding temptation—seems to suggest they fit better under the duty of loyalty, which is first and foremost a duty against self-dealing and other harmful conduct.

2. *The duty of loyalty as a perfect duty*

The application of prophylactic rules demonstrates that the fiduciary's duty of loyalty is primarily a negative duty to be followed without exception and regardless of the benefits that may redound to the fiduciary or the principal. Its philosophical underpinnings, in this sense, can be found in the writings of Immanuel Kant. Kant divided all duties between perfect and imperfect duties, and the duty of loyalty may be categorized as a perfect duty, "a duty which permits no exception in the interest of inclination."¹³⁴

Kant's discussion of perfect duties informs the fiduciary's duty of loyalty in two respects discussed above: the negative aspect of the duty, and the clear-cut nature of the rules.¹³⁵ First, perfect duties generally imply negative actions. Kant addressed the delicate interplay between acting in self-interest and acting in accordance with principles that may be universalized. Kant recognized that while one is capable of acting in accordance with principles that could be applied to everyone, at times one might respond to subjective conditions, applicable only to one or a small number of persons, and act in a way that cannot be universalized.¹³⁶ Some actions, Kant said, one cannot think of making universal (let alone actually wanting the actions to become universal) without presenting an internal contradiction.¹³⁷ It is these actions that one has a duty not to take.¹³⁸

133. See Custody of Investment Company Assets with a Securities Depository, Investment Company Act Release No. 25934 (Feb. 13, 2003) (adopting Investment Company Act rule 17f-4, 17 C.F.R. § 270.17f-4 (2004), governing a custodian's holding of mutual fund assets, and eliminating the requirements of earmarking and segregating, and substituting other requirements, including a requirement that the fund's custodian exercise "due care" to obtain and maintain financial assets).

134. IMMANUEL KANT, FOUNDATIONS OF THE METAPHYSICS OF MORALS 421 note (Lewis White Beck trans., Prentice-Hall 2d ed. 1990) (1785). Page references are to the Academy Edition's pagination.

135. See *supra* Part II.A.1.

136. KANT, *supra* note 134, at 412-13.

137. See *id.* at 424 (explaining that an internal contradiction is an irrationality in that "a certain principle [would be] objectively necessary as a universal law and yet subjectively [would] not hold universally but . . . [would] admit exceptions").

Kant's example is a person who considers borrowing money and promises to repay the loan knowing that repayment is impossible.¹³⁹ Kant asks if it is possible to universalize a proposition that would allow such conduct and concludes that such a universal proposition is laughable: the notion of promises to pay would quickly collapse.¹⁴⁰ The promisor would be relying on a universal principle requiring repayment, while at the same time, making an exception only for himself. He relies on the universal principle that one must keep promises to obtain the trust needed to receive a loan and then acts in contradiction to that principle.

The second way that Kant's discussion of perfect duties sheds light on the fiduciary's duty of loyalty is that perfect duties, like duties of loyalty, are unambiguous. Kant wrote that if a law cannot prescribe the precise way one must act and the extent of the actions, then the law results in an imperfect duty.¹⁴¹ He implies, therefore, that a law prescribing the precise actions that one must take, as well as the manner and extent of such actions, results in a perfect duty.¹⁴² A perfect duty, as noted, is one that "permits no exception in the interest of inclination."¹⁴³ Kant does not insist that perfect duties permit no exceptions, rather, he asserts that they do not permit exceptions in the interest of inclination.¹⁴⁴ The reason for this conclusion is that an exception in the interest of inclination could be asserted arbitrarily as an afterthought. A prohibition instead may be subject to limiting conditions that are not exceptions to a prohibition, but rather contained in the law itself.¹⁴⁵

138. *Id.* at 425.

139. *Id.* at 422.

140. *Id.*

141. IMMANUEL KANT, *THE METAPHYSICS OF MORALS* 390 (Mary Gregor trans., Cambridge Univ. Press 1991) (1797) (explaining that such a law leaves a "latitude for free choice," in that it does not specify how one is to act or how much one is to do to fulfill a duty). Page references are to the Academy Edition's pagination.

142. See MARY GREGOR, *LAWS OF FREEDOM* 97 (1963) ("When the obligation is perfect (*obligatio perfecta*) the law obliges strictly (is *stricte obligans*): when the obligation is imperfect the law is not of narrow but only of wide obligation (is *late obligans*).").

143. KANT, *supra* note 134, at 421 note.

144. *Id.*

145. A passage in Kant's *Perpetual Peace* supports this view. See generally IMMANUEL KANT, *PERPETUAL PEACE*, in IMMANUEL KANT, *CRITIQUE OF PRACTICAL REASON AND OTHER WRITINGS IN MORAL PHILOSOPHY* 347 (Lewis White Beck trans. & ed., Univ. of Chicago Press 1950) (1788). Kant discussed the difference between a command, a prohibition, and a permission. Kant criticized the use of a permission as an *exception* to a prohibition. Rather, he argued for the concept of a *permissive law*, stating that permission should be introduced into a prohibition not as an exception, but as a limiting condition of the prohibition itself. An exception is added arbitrarily, whereas a condition is introduced into the formula of the prohibition itself, and becomes a permissive law. He wrote, "These exceptions are added to the law only as

Similarly, exceptions to the duty of loyalty generally are contained in the law itself. The requirement that a fiduciary not transact with his principal absent consent serves as an example. Consent is not an exception from the requirement to perform one's duty that can be asserted as an afterthought; rather, the notion of consent is contained in the rule itself so that transacting with one's principal after obtaining consent accords with duty and is permitted. This notion is consistent with the treatment of consent in tort law. Consent generally bars recovery for interferences with person or property, not because it is an affirmative defense, but because it proves that the tort never occurred. Consent is a negative element of the tort. Prosser and Keeton wrote that it is a "fundamental principle of the common law that *volenti non fit injuria*—to one who is willing, no wrong is done."¹⁴⁶

Modern formulations of fiduciary duties reflect that consent is a negative element of a breach. The Second Restatement of Trusts provides that the trustee is "under a duty not to profit at the expense of the other and not to enter into competition with him without his consent."¹⁴⁷ The Third Restatement of the Law Governing Lawyers says that a lawyer may not represent two clients whose interests may conflict unless the clients consent.¹⁴⁸ The point is not that the duty of loyalty requires the fiduciary to comply with rigid rules, but rather that the flexibility the fiduciary enjoys through consent is contained

an afterthought required by our groping around among cases as they arise, and not by any principle. Otherwise the conditions would have had to be introduced into the formula of the prohibition, and in this way it would itself have become a permissive law." *Id.* See also GREGOR, *supra* note 142, at 101 (restating Kant's preference for permissive laws over exceptions).

146. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 112 (5th ed. 1992); see RESTATEMENT (SECOND) OF TORTS § 892A cmt. a (1977) (asserting that one does not suffer a legal wrong as the result of an act to which, unaffected by fraud, mistake or duress, he freely or apparently consents).

147. RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b (1957). The ABA's rule on confidentiality states, "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent . . ." MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2000). When the ABA amended the Model Rule recently to permit disclosure to prevent the client from committing certain crimes or frauds or to address injuries that result, the ABA included a requirement that client used the lawyer's services to further the crime or fraud. As a result, the ABA was able to argue that such use constitutes an abuse of the attorney-client relationship so that the client "forfeits the protection of this Rule." This is not the same as providing for an exception, rather, the rule is no longer relevant because the client has acted to purge its applicability. See ABA, Task Force on Corporate Responsibility, MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. 7. See also Frankel, *supra* note 1, at 1232 (recognizing that the lack of an owner's consent is an element of the wrong associated with a fiduciary's misappropriation of entrusted property and power).

148. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 128 (2000).

in the rules governing the fiduciary's conduct and may not be presented after the fact as a justification for breach.

These two aspects of the duty of loyalty—that the duty is negative and unambiguous—and the discussion of the duty of loyalty as a perfect duty, help explain what is meant by the duty of loyalty in the fiduciary context. They also help to contrast the duty of loyalty with the duty of care.

B. The Duty of Care

The duty of loyalty to refrain from harming the principal represents only the first aspect of the fiduciary duty. A fiduciary at common law also must act with strict obeisance to the duty of care. Pomeroy articulated the division between the duty of loyalty and the duty of care with respect to trustees:

The second branch of the trustee's obligation is to use care and diligence in the discharge of his functions. This duty is very comprehensive; it extends through the entire range of his conduct; it is entirely independent of the question of good faith, for he will be liable for its failure even when no wrongful intent nor violation of good faith is charged upon him.¹⁴⁹

149. POMEROY, *supra* note 104, at § 1066.

1. *The nature of the duty of care*

a. *Positive duties*

The duty of care is a positive duty.¹⁵⁰ It arises from control or discretion that the fiduciary exercises over the principal's affairs. Control gives the fiduciary the means to take steps to act for the principal's benefit and is necessary to engage in the very conduct that the parties agreed the fiduciary will perform.¹⁵¹ In fact, one may think of the duty of care in the first instance as a duty to maintain control.¹⁵² When company directors, for example, support the transfer of corporate control, they are held to a heightened level of care.¹⁵³ And

150. One may draw lessons about the two branches of fiduciary duties from comparative law. German law also distinguishes between negative and positive duties in this area. Section 266 of the German Criminal Code, entitled Breach of Trust, covers much of the conduct governed by fiduciary law in common law systems. Section 266(1) of the code contains two requirements. The first is a *prohibition against abuse of power*. The second is a requirement to *safeguard property interests* of another. The German text reflects the negative and positive aspects of the duty. The first is a prohibition against *Mißbrauch*, meaning abuse, misuse, or improper use. The second is a requirement of *Wahrnehmen*, meaning to preserve, safeguard, or protect. See, e.g., AMERICAN SERIES OF FOREIGN PENAL CODES: THE GERMAN PENAL CODE 159 (Stephen Thaman trans., 2002) (translating § 266 StGB, a portion of the German penal code).

Section 266 is used to prosecute what Anglo-American lawyers call breach of fiduciary duty, although Germans refer to it as breach of trust. The prosecution of Deutsche Bank CEO and Mannesmann board member, Josef Ackerman, for example, for awarding excessive bonus compensation to Mannesmann executives allegedly to convince them to refrain from opposing a Mannesmann takeover by Vodafone, was brought under section 266 and described by Anglo-American sources as a breach of fiduciary duty case. See Landgericht Düsseldorf, *Mitteilung der Pressestelle, Hauptverfahren im "Mannesmann-Verfahren" eröffnet* [Press Release: Trial begins in the Mannesmann case] (2004), available at <http://www.lg-duesseldorf.nrw.de/presse/dokument/04-01.pdf>.

151. Many courts recognize that a fiduciary has significant power over the principal. See, e.g., *Broussard v. Meineke Disc. Muffler Shops, Inc.*, 155 F.3d 331, 348 (4th Cir. 1998) (noting that a fiduciary relationship arises when one party "figuratively holds all the cards—all the financial or technical information, for example"); *United States Nat'l Bank of Portland v. Guiss*, 331 P.2d 865, 876 (Or. 1958) (commenting that a fiduciary relationship often gives one party the power and means "to take undue advantage of, or exercise undue influence over, the other" (quoting 23 AM. JUR. *Fraud and Deceit* § 14 (2004))); *Pomroy v. Dep't of Pub. Welfare*, 750 A.2d 395, 399 (Pa. Commw. Ct. 2000) (stating that a fiduciary relationship clearly arises when one is legally vested with the power to control funds owned by an incompetent).

152. See RESTATEMENT (SECOND) OF TRUSTS § 175 (1959) (explaining that the trustee's duty of care includes taking reasonable steps to acquire and maintain control of trust property); POMEROY, *supra* note 104, at §§ 1068-1069 (defining the duty of care and diligence as the duty to maintain control over the trust property and not to delegate authority or surrender control, and further noting that, if a co-trustee exists, one trustee cannot surrender control of trust property and performance of trust duties to the co-trustee).

153. See *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 (Del. 1993) (holding that a director's conduct is subject to enhanced scrutiny in two instances: (1) the approval of a sale of corporate control, and (2) the adoption of

recently, the surrender of control by board members to one individual has been blamed in part for failures in corporate governance.¹⁵⁴

Cases in the area of directors' liability distinguish between negative duties under the duty of loyalty and positive duties under the duty of care. The leading case of *Smith v. Van Gorkom*¹⁵⁵ is illustrative. The plaintiffs challenged a decision by Trans Union Corporation's board of directors to approve a merger with another company.¹⁵⁶ The Delaware Court of Chancery, after trial, granted judgment for the directors, and the Supreme Court of Delaware reversed.¹⁵⁷ The court stated that "fulfillment of the fiduciary function requires more than the mere absence of bad faith or fraud . . . [and imposes] an affirmative duty to protect those interests and to proceed with a critical eye in assessing information."¹⁵⁸ Similarly, in *Paramount Communications, Inc. v. QVC Network Inc.*,¹⁵⁹ the Delaware Supreme Court invalidated a merger agreement between Paramount and Viacom, which discouraged competing bids. In determining that the Paramount directors violated their fiduciary duties, the court recited a list of matters that the directors should have considered, including whether either offer could have been improved, whether the parties could actually complete the deal, alternative courses of action, timing constraints, and other available information.¹⁶⁰

Other cases refer to a duty of directors to inform themselves of all material information reasonably available before making a decision;¹⁶¹ an "active duty" to learn about the affairs of a corporation and what

defensive measures in response to a threat to corporate control). The Delaware Supreme Court noted that these events have a significant impact on stockholders and that they represent a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise. *Id.* at 47-48; *see also* Brudney, *supra* note 2, at 262 (recognizing that efforts by corporate insiders to preserve or alter control arrangements for their own benefit may diminish the value of the stockholder's vote and, as a result, bring into play the insider's fiduciary role).

154. *See, e.g.*, DENNIS R. BERESFORD ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF WORLD COM, INC. 30 (Mar. 31, 2003) (noting that the Board of Directors' failure in corporate oversight resulted, in part, from that fact that they had surrendered leadership to CEO Bernard Ebbers and, in some cases, viewed their roles as diminished), *at* <http://news.findlaw.com/hdocs/docs/worldcom/bdspcomm60903rpt.pdf> (on file with the American University Law Review).

155. 488 A.2d 858 (Del. 1985).

156. *Id.* at 863.

157. *Id.* at 864.

158. *Id.* at 872.

159. 637 A.2d 34 (Del. 1993).

160. *Id.* at 49.

161. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

could be done to improve them;¹⁶² and, in the case of a contest for corporate control, a duty to encourage the highest possible price, or canvass the market to determine if higher bids may be elicited.¹⁶³ An allegation that a director has not taken steps to actively monitor some aspect of the company's affairs is an allegation of a breach of the duty of care, not the duty of loyalty.¹⁶⁴

The Corporate Director's Guidebook states that, in addition to the duty of loyalty, "the corporate director also assumes a duty to act carefully in fulfilling the important tasks of monitoring and directing the activities of corporate management."¹⁶⁵ The Guidebook expresses the director's duty of care as a series of positive undertakings, a "duty of attention" characterized as "a responsibility to participate actively in the oversight of the enterprise's activities."¹⁶⁶ Such participation includes attending meetings, reviewing adequate information, reviewing documentation, and monitoring delegated activities.¹⁶⁷ Finally, while the doctrine of the duty of care is largely judge-made law, when assimilating fiduciary language into statutory text, Congress has distinguished between positive and negative duties as well.¹⁶⁸

The fiduciary duty for lawyers embodies similar themes about the nature of the duty of care. The American Bar Association notes, "At the core of the duty of diligence is a lawyer's obligation to actually perform the work for which she was hired."¹⁶⁹ Under the rubric of duties of competence and diligence, the Third Restatement of the

162. *Barnes v. Andrews*, 298 F. 614, 616 (S.D.N.Y. 1924).

163. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286-87 (Del. 1989).

164. *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (articulating plaintiffs' complaint as charging defendants with breaching their duty of care in operating the corporation because they failed to be active monitors of corporate affairs); *see also* BERESFORD ET AL., *supra* note 154, at 31 (attributing WorldCom's failures in corporate governance, in part, to the Board of Director's detachment from corporate affairs).

165. ABA COMM. ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK, *reprinted in* 33 BUS. LAW. 1591, 1600 (1978).

166. *Id.*, *reprinted in* 33 BUS. LAW. at 1602.

167. *Id.*; *cf.* WILLIAM POWERS ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. (Feb. 1, 2002) (finding that the Enron Board of Directors failed in its duty to monitor certain transactions and to react to warning signs in those transactions), *at* <http://news.findlaw.com/hdocs/docs/enron/sicreport> (on file with the American University Law Review).

168. *See, e.g.*, H.R. REP. NO. 1382, at 37 (1970) (explaining that the application of section 36(a) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(a) (2000), which governs the conduct of mutual fund directors, is not limited to "situations where an actual intent to violate the law [is] shown or to acts of affirmative misconduct," and noting that "nonfeasance of duty or abdication of responsibility" may constitute a breach of fiduciary duty under the Act); S. REP. NO. 184, at 36 (1969) (containing identical language to H.R. REP. NO. 1382, at 37 (1970)).

169. ABA/BNA LAWYER'S MANUAL ON PROFESSIONAL CONDUCT 31:402 (1997).

Law Governing Lawyers requires that a lawyer's knowledge and skills be used to perform the services required by the client's objectives.¹⁷⁰ Under Standard of Care, the Restatement provides that such duties may include "inquiry into the facts, analysis of the law, exercise of professional judgment, communication with the client, rendering of practical and ethical advice, and drafting of documents."¹⁷¹ The Supreme Court has contrasted the lawyer's "duty of loyalty, a duty to avoid conflicts of interest" with the "overarching duty to advocate the defendant's cause and the more particular duties to consult with the defendant on important decisions and to keep the defendant informed of important developments in the course of the prosecution."¹⁷² The same is true for trustees. When the Second Restatement of Trusts describes the duty to administer a trust, it emphasizes the duty of care.¹⁷³

b. Open-ended duties

The nature of the fiduciary's duty of care, unlike the duty of loyalty, is positive, but it is also open-ended and uncertain.¹⁷⁴ A frequent bromide is that the fiduciary has a duty of utmost care to treat the principal as if the principal were the fiduciary himself.¹⁷⁵

170. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52 cmt. c (1998).

171. *Id.*

172. Strickland v. Washington, 466 U.S. 668, 688 (1984).

173. See RESTATEMENT (SECOND) OF TRUSTS § 174 (1959) (stating that a trustee's duty of care is to "exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property"); see also *id.* at § 176 (explaining that a trustee must use appropriate care and skill to preserve trust property); *id.* at § 172 (noting that the trustee is obligated to keep and render clear and accurate accounts); cf. Otto v. Niles, 106 F.3d 1456, 1462 (9th Cir. 1997) (explaining that requiring trustees to keep and render clear and accurate accounts reinforces the policies behind fiduciary law by ensuring that trustees perform their obligations faithfully and with care (citing RESTATEMENT OF TRUSTS § 172 (1959))).

174. See Weinrib, *supra* note 2, at 7 ("The reason that agents, trustees, partners, and directors are subjected to the fiduciary obligation is that they have a leeway for the exercise of discretion in dealings with third parties which can affect the legal position of their principals."); see also Clark, *supra* note 1, at 73 (stating that, with corporate managers, the open-ended nature of legally imposed duties is substantial, as they are empowered to manage corporate affairs but limited by the duty of care in exercising those powers). Clark also states that the duty of loyalty is open-ended; but here he refers to the application of the duty to potentially new fiduciary relationships, not to the nature of the duty of loyalty. *Id.* at 219 n.31.

175. See, e.g., SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 194 (1963) (stating that courts have imposed an affirmative duty on fiduciaries of "utmost good faith"); Lawton v. Nyman, 327 F.3d 30, 38 (1st Cir. 2003) (noting that a fiduciary relationship imposes upon the fiduciary the duty to act with utmost good faith); Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992) (Posner, J.) (explaining that a fiduciary must treat his principal with the utmost care, loyalty, and good faith, as the fiduciary would treat himself); Jenkins v. Jenkins, 64 P.3d 953, 957 (Idaho 2003) (concluding that corporate directors must act with the utmost good faith in managing a corporation); *In re Disciplinary Proceedings Against McKean*, 64 P.3d

The courts, however, do not explain what they mean by utmost care and in some cases seem to be promoting a supererogatory norm.¹⁷⁶ The word “utmost” suggests the most extreme or outer limit. In most duty of care cases, however, the most extreme or outer limit cannot be defined, and therefore, cannot be achieved. In this sense, one could describe the demands placed on a fiduciary under the rubric of the duty of care as aspirational. Professors James Henderson and Richard Pearson wrote an article in the 1970s about the limits of aspirational commands in enforcing federal environmental policies.¹⁷⁷ The objective of many tasks, they explained, are subject to resource limitations.¹⁷⁸ “[T]he phrase ‘as best he can’ does not require a single-minded, ‘drop everything else’ approach to performing the task. Instead, aspiration requires that, within these limitations, an actor will perform to the best of his ability.”¹⁷⁹

Fiduciaries frequently carry out their responsibilities under the yoke of such limitations. Consider the example of a trustee managing trust assets. A diligent trustee could spend a majority of his time determining how to invest. Is the trustee obligated to spend eight hours each day doing so? Why not spend sixteen hours each day, only taking time to sleep and eat? The same is true for attorneys. Courts have stated that an attorney has a duty to be a zealous advocate¹⁸⁰ and defend a client’s case to the utmost.¹⁸¹ Many complex

1226, 1233 (Wash. 2003) (recognizing that MODEL RULES OF PROF’L CONDUCT R 1.14 requires an attorney to handle his client’s property with the “utmost care, transparency, and prudence”).

176. See, e.g., *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C.J.) (concluding that a trustee is held to “something stricter than the morals of the marketplace” and explaining that “not honesty alone, but the punctilio of an honor the most sensitive, is . . . the standard of behavior”); see also *Nat’l Union Fire Ins. Co. of Pittsburgh v. Cagle*, 68 F.3d 905, 912 (5th Cir. 1995) (acknowledging that the fiduciary obligation may impose an affirmative duty to disclose facts beyond that required by contract); *McConaghy v. Sequa Corp.*, 294 F. Supp. 2d 151, 164 (D.R.I. 2003) (agreeing with the plaintiff’s argument that the defendants, as fiduciaries, had heightened duties of loyalty and care greater than those owed by an ordinary tortfeasor).

177. James A. Henderson, Jr. & Richard N. Pearson, *Implementing Federal Environmental Policies: The Limits of Aspirational Commands*, 78 COLUM. L. REV. 1429 (1978).

178. *Id.* at 1430.

179. *Id.*

180. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835, 842 (9th Cir. 2001) (acknowledging that an attorney must represent his client zealously and protect his client’s legal rights); *United States v. Cavin*, 39 F.3d 1299, 1308 (5th Cir. 1994) (noting that one of the basic tenets of the adversarial legal system is that an attorney owes his client zealous representation, including the advocacy of those positions which have an arguable basis despite contrary authority); *Sanders v. Ratelle*, 21 F.3d 1446 (9th Cir. 1994) (asserting that an attorney must zealously represent his client and finding that an attorney who refused to listen to key information regarding his client’s most important defense failed to provide such representation);

matters, however, could benefit from nearly infinite preparation. It is a rare case when an attorney would do nothing more to prepare if given additional time. The press of other work and matters outside the office, however, generally will not allow most attorneys to spend eight hours each day, let alone sixteen, preparing a single matter.¹⁸² A leading case propounding the duty of mutual fund trustees states that whether trustees are “fully informed about all facts” bearing on certain matters related to the fund is important to determine whether the trustees have breached their fiduciary duties.¹⁸³ But complete knowledge on any matter is unattainable. Sissela Bok makes a similar point about a promise to tell the *whole truth*.¹⁸⁴ The whole truth on any particular topic, she wrote, is probably unknowable, and if it were knowable, it would require weeks or months of explanation.¹⁸⁵

Courts recognize that it is simply not possible for a fiduciary to be aware of every piece of relevant information before making a decision on behalf of the principal, and a fiduciary cannot guarantee that a correct judgment will be made.¹⁸⁶ In approving a settlement of a derivative action in *In re Caremark International Inc.*,¹⁸⁷ the Delaware Chancery Court examined the director’s duty to monitor the affairs of the corporation and stated that the director’s duty to be informed does not require directors to have detailed knowledge about all aspects of the corporation.¹⁸⁸ This responsibility would be “inconsistent with the scale and scope of efficient organization size in this technological age.”¹⁸⁹ In *Barnes v. Andrews*,¹⁹⁰ the court examined

Cont’l Cas. Co. v. Pullman, Comley, Bradley & Reeves, 929 F.2d 103, 106 (2d Cir. 1991) (stating that an attorney has a duty of “robust representation” of his client’s interests).

181. See *Lipsett v. Blanco*, 975 F.2d 934, 941 (1st Cir. 1992) (stating that an attorney has a duty to pursue or defend his client’s case to the utmost and describing that duty as taking steps to resolve litigation on terms that are most favorable to the client).

182. Cf. *id.* (pointing out that pursuing or defending a case to the utmost may contradict the overarching duty to resolve a legal matter on terms that are most favorable to the client).

183. *Gartenburg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 930 (2d Cir. 1982).

184. SISSELA BOK, *LYING: MORAL CHOICE IN PUBLIC AND PRIVATE LIFE* 4 (1999).

185. *Id.* Cooter and Freedman made a similar point in economic terms. See Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1057-59 (1991) (arguing that a fiduciary would be acting unreasonably if the marginal cost of her effort exceeded the resultant marginal benefit to the principal).

186. See *infra* notes 187, 190.

187. 698 A.2d 959 (Del. Ch. 1996).

188. *Id.* at 971.

189. *Id.* Recent research in the cognitive sciences confirms the futility of requiring senior executives to possess large amounts of data and detailed information when making business decisions. Kathleen M. Sutcliffe & Klaus Weber,

whether a director failed in his duty to pay adequate attention to the affairs of a corporation and should be liable for the collapse of the enterprise. In his opinion, Learned Hand explained, "The measure of a director's duties in this regard is uncertain; the courts contenting themselves with vague declarations, such as that a director must give reasonable attention to the corporate business."¹⁹¹

Attorney rules of conduct also recognize limitations on the attorney's ability to gather, analyze, and act on information. The Rules of Professional Conduct state that a lawyer should represent a client zealously, but they add that an attorney is not required to press for every possible advantage that may be available for a client.¹⁹² The Supreme Court, in *Strickland v. Washington*,¹⁹³ stated that no set of detailed rules regarding an attorney's conduct can possibly take into account the variety of circumstances faced by defense counsel.¹⁹⁴ Moreover, no two lawyers would represent a client in exactly the same way.¹⁹⁵ Both the majority and dissenting opinions in *Strickland* stated that counsel must be afforded "wide latitude" in performing his duties.¹⁹⁶ Likewise, no one expects the decisions of a fiduciary to be perfect. The Delaware Supreme Court stated its task was not to decide "whether the directors made a perfect decision" but whether it was within a range of reasonableness.¹⁹⁷

The High Cost of Accurate Knowledge, HARV. BUS. REV., May 2003, at 74 (questioning the traditional assumption that additional investments in obtaining information improve accuracy in decision-making and help companies adapt to a changing environment).

190. 298 F. 614 (S.D.N.Y. 1924).

191. *Id.* at 615; see also Henderson, Jr. & Pearson, *supra* note 177, at 1435-38 (reflecting on the vagueness inherent in aspirational commands).

192. D.C. RULES OF PROF'L CONDUCT R. 1.3 & cmt. 1 (2004). Not only is the lawyer not required to press for every advantage, a lawyer may lose most of his cases and still be practicing consistently with his duty of care. Under the adversarial system, most attorneys cannot win every case, and no one would suggest that a lawyer has breached his duty because he failed to do so. Malpractice cases recognize that an attorney "is not a guarantor of the results," *Helmbrecht v. St. Paul Ins. Co.*, 362 N.W.2d 118, 130 (Wis. 1985), and the RESTATEMENT OF THE LAW GOVERNING LAWYERS provides that the duty of competence, like the duty of diligence, "does not make the lawyer a guarantor of a successful outcome in the representation." RESTATEMENT OF THE LAW GOVERNING LAWYERS § 52 cmt. b, at 376 (2004) (citation omitted). In fact, in performing his fiduciary duty, the lawyer may not only lose a particular case, but he may generally perform well below average. Otherwise, half of the profession would regularly be guilty of malpractice. *Id.*

193. 466 U.S. 668 (1983).

194. *Id.* at 688-89.

195. See GEORGE P. FLETCHER, A CRIME OF SELF-DEFENSE: BERNHARD GOETZ AND THE LAW ON TRIAL 8 (1988) (discussing Bernhard Goetz's decision to replace his court appointed attorney with an attorney who favored a different defense as an example of how clients may choose among attorneys who display different styles, strengths, and weaknesses).

196. *Strickland*, 466 U.S. at 689, 709 (Marshall, J., dissenting).

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

This discussion reveals that one must evaluate the duty of care, unlike the duty of loyalty, by the process the fiduciary undertakes in performing his functions and not the outcome achieved. The very word “care” connotes a process. One associates caring with a condition, state of mind, manner of mental attention, a feeling, regard, or liking for something.¹⁹⁸ How else may one determine whether a financial adviser who regularly achieves below average returns, or an attorney who loses most cases, has performed his duty of care? It is only through evaluating the steps the fiduciary took while doing his job, and not whether they resulted in success, that one may judge whether the fiduciary has breached his duty.

The emphasis on process in duty of care cases is embodied in the business judgment rule in corporate law.¹⁹⁹ Judges in common law courts of general jurisdiction cannot possibly second-guess every decision made by a board of directors, and a court’s function is not to resolve questions of policy, resources, and judgment for the board. Thus, while a director’s fiduciary duty entails positive actions to benefit the corporation and its shareholders, courts presume that, absent fraud, self-dealing or other instances of bad faith (a breach of the duty of loyalty), a director makes good faith decisions.²⁰⁰ It is

198. See THE OXFORD ENGLISH DICTIONARY 893-94 (J.A. Simpson & E.S.C. Weiner eds., 2d ed. 1989).

199. See, e.g., *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (explaining that liability for a breach of duty does not arise because the judge or jury thought that a director made an incorrect decision, but rather, the court must determine whether the director’s process in reaching the decision was rational or made in good faith to advance corporate interests).

200. See generally DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS (5th ed. 1998) (arguing that the business judgment rule creates a presumption that directors acted with due care). Illustrations of the business judgment rule arise in all aspects of American business life. Courts must defer to directors’ judgment lest they be forced to make decisions on matters ranging from employment agreements, *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998), to conflicting claims among security holders, *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879 (Del. Ch. 1999), and to depleting corporate assets, *Rosenfield v. Metals Selling Corp.*, 643 A.2d 1253 (Conn. 1994).

That courts may not agree with the judgment of directors is evident from case law. An interesting example is *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. Ct. App. 1968). Stockholders of the Chicago National League Ball Club, owner of the Chicago Cubs, brought a derivative action against Philip Wrigley and other directors of the company for failing to install lights at Wrigley Field and schedule night games. *Id.* at 777. The plaintiffs argued that since night baseball was first played in 1935, nineteen of the then twenty major league teams had scheduled night games. *Id.* If the directors of the Chicago ball club continued to be obstinate, the Cubs would face another season of operating losses. *Id.* They argued that Philip Wrigley, who owned eighty percent of the company, refused to install lights not because of the shareholders’ interest but because of his personal view that baseball is a daytime sport. *Id.* at 777-78. The court, however, would not ascribe improper motives to Wrigley. *Id.* at 780. It searched instead for what may have been an appropriate rationale for Wrigley’s actions, such as preserving the surrounding neighborhood,

precisely in the decision-making process that the duty of care arises, and the courts recognize that “a director’s duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty.”²⁰¹ Recent attempts to buttress the duty of care for company directors through administrative rulemaking highlight the emphasis on process in doing the director’s job.²⁰²

The duty of care for other fiduciaries is similarly process-determinative. In deciding whether a conviction must be set aside for ineffective assistance of counsel, the Supreme Court stated that a “fair assessment of attorney performance requires that every effort be made to eliminate the distorting effects of hindsight, to reconstruct the circumstances of counsel’s challenged conduct, and to evaluate the conduct from counsel’s perspective at the time.”²⁰³ Cases examining a trustee’s duty of care make the same point. In a New York case where beneficiaries alleged that a trustee should have been

and then deferred to Wrigley’s judgment, despite that it may have disagreed: “By these thoughts we do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability. We are merely saying that the decision is one properly before directors.” *Id.*

201. *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985); *see In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d at 967-68 (remarking on the process-oriented nature of the business judgment rule that is based on a respect for all good faith board decisions).

202. *See, e.g.*, Securities Exchange Act Rule 10A-3(b)(2), 17 C.F.R. § 240.10A-3(b)(2) (2004) (stating, “The audit committee of each listed issuer, in its capacity as a committee of the board of directors, must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged . . . for the purpose of preparing or issuing an audit report.”).

In adopting the rules, the SEC stated that it was not establishing specific rules governing the audit committee, rather, that “specific decisions regarding the execution of the audit committee’s oversight responsibilities, as well as decisions regarding the extent of desired involvement by the audit committee, are best left to the discretion of the audit committee of the individual issuer in assessing the issuer’s individual circumstances.” Standards Relating to Listed Company Audit Committees, Securities Act Release No. 8220, 68 Fed. Reg. 18788, 18796 (Apr. 16, 2003).

203. *Strickland v. Washington*, 466 U.S. 668, 689 (1983). In this case, the trial judge, due to aggravating circumstances, sentenced the respondent to death. *Washington v. State*, 362 So. 2d 658, 663-64 (Fla. 1978). The respondent alleged he was denied effective assistance of counsel and outlined specific actions that he believed his attorney should have taken, such as moving for a continuance to prepare for sentencing, requesting a psychiatric report, investigating and presenting character witnesses, seeking a pre-sentence investigation report, presenting meaningful arguments, and investigating the medical examiner’s reports or cross-examining the experts. *Id.* By the time the case reached the Supreme Court, all federal and most state courts had adopted the “reasonably effective assistance” standard in assessing attorney performance, but the Supreme Court had not yet addressed the proper standard. *Strickland*, 466 U.S. at 683-84. In doing so, the Court emphasized process over outcome and said it is “all too easy” for a court to conclude after the fact that a particular act or omission was unreasonable and, as such, the Court refused to do so. *Id.* at 689, 698.

prescient enough to sell shares of a utility company before the onset of the Great Depression, the court expressed that the trustee's conduct must be viewed from the perspective of the trustee's actions at the time the actions occurred:

[T]he trustee's conduct is not to be judged from the vantage point of hindsight; instead, it must be considered prospectively—the flashback method must be employed, unaided or enlightened by subsequent events. To decide in the tranquil afterwards what the trustee should have done during the period of irresolution, is not easy. Yet that is the unenviable task the Court is called upon to perform.²⁰⁴

The Second Restatement of Trusts similarly provides, “Whether the trustee is prudent in the doing of an act depends upon the circumstances as they reasonably appear to him at the time when he does the act and not at some subsequent time when his conduct is called in question.”²⁰⁵ One may certainly find exceptions where courts look to the outcome of an action, and not the process followed with respect to that action, to determine whether a fiduciary breached the duty of care. Those exceptions, however, typically arise in special circumstances or as the result of a particular statutory scheme that warrant a departure from the common law rule.²⁰⁶

204. *In re Pate's Estate*, 84 N.Y.S.2d 853, 858 (Sur. Ct. 1948) (citations omitted).

205. RESTATEMENT (SECOND) OF TRUSTS § 174 cmt. b (2004).

206. *See, e.g., Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982). *Gartenberg* analyzed standards courts should apply when determining whether fees paid by a mutual fund to an adviser to manage the fund are excessive under Section 36 of the Investment Company Act of 1940, 15 U.S.C.A. § 80a-35(b) (1987). In that case, mutual fund shareholders brought a derivative action against the fund, the fund's investment adviser, and other affiliates of the fund, alleging that the fee the fund agreed to pay its adviser was so high that it constituted a breach of fiduciary duty under the Act. *Id.* at 926-27. The court adopted, at least in part, an outcome-oriented approach, stating that for a violation to occur, the adviser must charge a fee “so disproportionately large that it bears no reasonable relation to the services rendered and could not have been the product of arm's-length bargaining.” *Id.* at 928. The court also stepped away from the lower court's ruling, which, in deciding whether the adviser violated its fiduciary duty, “gave weight to the process” by which the disinterested trustees of the fund approved the management agreement. *Id.* at 927. The court of appeals stated that even if the trustees were fully informed of all facts bearing on the adviser's fee and performed their duties conscientiously—even if the process were sound—if the result was a disproportionately large advisory fee, that alone could give rise to a breach of duty by both the trustees and the investment adviser. *Id.* at 930. The appeals court concluded that the plaintiffs failed to prove that the fees charged were so excessive or unfair as to amount to a breach of duty and pointed out that fund investors, while not realizing the highest possible return on their investment, enjoyed a better-than-average return. *Id.*

2. *The duty of care as an imperfect duty*

The previous discussion illuminates the nature of the duty of care as ambiguous and process-oriented. It contrasts with the duty of loyalty, which requires negative conduct and is generally not ambiguous. Drawing on Kant, one may call the duty of loyalty a perfect duty. The fiduciary's duty of care, by contrast, requires affirmative conduct to act in the principal's interest with respect to the assets or affairs of the principal entrusted to the fiduciary. The fiduciary relationship, as discussed, arises when the fiduciary agrees to act for the benefit of the principal. The Third Restatement of Trusts provides, "Despite the differences in the legal circumstances and responsibilities of various fiduciaries, one characteristic is common to all: a person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship."²⁰⁷ The fiduciary, therefore, has agreed to make the interest of the principal his purpose or his end. The duty to take affirmative steps to further the interests of another is similar to what Kant described as an imperfect duty,²⁰⁸ and the fiduciary's duty of care is one illustration of Kant's imperfect duty.

Kant's example of an imperfect duty to others is the duty to contribute to their welfare or assistance.²⁰⁹ The duty is positive; it requires particular acts to be taken for their benefit. Kant asks what is wrong with simply not injuring others—why does one have to take positive steps to assist them?²¹⁰ He answers his question by explaining that it is not possible to desire this way of thinking to be universal.²¹¹ If it were universal, while society could continue to exist, and perhaps be better off than a society fraught with cheating and betrayal, it is not possible to wish for this state of affairs to be universal. Instances inevitably would arise where we each would desire the assistance of others and we will have robbed ourselves of that opportunity.²¹²

207. RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b (2003); see RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958) (defining a fiduciary as one who acts primarily for the benefit of the principal); see also Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 540 (1949) (defining a fiduciary as a person who acts in the interest of another).

208. KANT, *supra* note 134, at 430 (characterizing the decision to help others as a positive action towards harmonization with humanity, as opposed to merely refraining from harming others, which is negative action).

209. *Id.*

210. See *id.* at 423 ("What concern of mine is it? Let each one be happy as heaven wills, or as he can make himself; I will not take anything from him or even envy him; but to his welfare or to his assistance in time of need I have no desire to contribute.") (citations omitted).

211. *Id.*

212. *Id.*

While perfect duties are generally negative, imperfect duties are generally positive. When discussing the duty to contribute to the welfare of others, Kant wrote:

Humanity might indeed exist if no one contributed to the happiness of others, provided he did not intentionally detract from it, but this harmony with humanity as an end in itself is only negative, not positive, if everyone does not also endeavor, as far as he can, to further the purposes of others.²¹³

Kant analyzed the open-ended nature of imperfect duties in his *Metaphysics of Morals*.²¹⁴ While one has a duty to promote the welfare of others, he wrote, “it is impossible to assign specific limits to the extent of this sacrifice.”²¹⁵ In determining such limits, decisions have to be made on a case-by-case basis. The duty to promote the welfare of others “depends, in large part, on what each person’s true needs are in view of his sensibilities, and it must be left to each to decide this for himself.”²¹⁶ Kant recognized that the goal of promoting the happiness of others at the sacrifice of one’s own happiness presents an internal contradiction. “Hence” he says, “this duty is only a *wide* one; the duty has in it a latitude for doing more or less, and no specific limits can be assigned to what should be done.”²¹⁷

An open-ended duty without specific limits describes the fiduciary duty of care. The doctrine of the duty of care leaves leeway between the objective of promoting the well-being of the principal and the actions one must take in furtherance of that objective. One cannot draw up a checklist of actions to fulfill the duty. Rather, the duty lies in making the end of the principal the fiduciary’s purpose, and it is largely left to the fiduciary to make proper judgments and act accordingly. Mary Gregor has explained that imperfect duties consist in the adoption of ends, not in determinate actions.²¹⁸ They leave latitude between our aims, or our ends, and in the actions required for the realization of these aims. It is in this latitude where judgment determines action not specified by law.²¹⁹

Under this analysis, one faces a puzzle with respect to the implications for fiduciary doctrine. If the actions required to fulfill imperfect duties are not specified by law, then taking such actions

213. *Id.* at 430.

214. KANT, *supra* note 141, at 390-93.

215. *Id.* at 393.

216. *Id.*

217. *Id.* In describing the duty, Kant uses the German word, *Spielraum*, literally “playroom,” which perhaps better captures its essence than the English word “latitude.”

218. GREGOR, *supra* note 142, at 96.

219. *Id.*

arguably is not a legal duty.²²⁰ While imperfect duties generally are not legal duties, the fiduciary duty of care, of course, is a legal duty. How can this be? As discussed, law cannot stipulate when one has fulfilled imperfect duties because they are open-ended. No one can say with certainty whether the fiduciary must spend four, eight, or twelve hours a day promoting the ends of the principal. But the prophylactic rules discussed above, which ensure that the fiduciary not act against the interests of the principal, also ensure that when the principal does act, the acts are done, not out of self-interest, but to promote the ends of the principal.²²¹ By forcing the fiduciary to refrain from transacting with the principal, for example, the fiduciary is forced to refrain from acting out of self-interest. Garden-variety transactions between the fiduciary and his principal, therefore, are prohibited. These prophylactic rules ensure that when the fiduciary acts, he acts to promote the ends of his principal and not his own ends.²²²

The old Supreme Court cases discussed above capture the point. In *Michoud v. Girod*,²²³ the Court held that the prophylactic rule—the disability to purchase—“imposes” the duty on a fiduciary to protect the interests of the principal.²²⁴ How is it that a negative duty imposes a duty to protect? The Court’s concern was that the principal’s “own personal interest may withdraw him” from the faithful discharge of his duty.²²⁵ The prophylactic rule “prohibits a party from purchasing on his own account that which his duty or trust requires him to sell on account of another, and from purchasing on account of another that which he sells on his own account.”²²⁶ Thus, when the fiduciary is required to sell or purchase for the account of the principal, if the fiduciary cannot transact with the principal for the fiduciary’s own

220. See KANT, *supra* note 141, at 390 (arguing that the law’s inability to clearly specify which actions one must take to fulfill imperfect duties creates room for the exercise of free choice in compliance with those duties).

221. Some have referred to this as the exclusive benefit principle. See Brudney, *supra* note 1, at 599 n.9, 603 (explaining that the duty of loyalty requires the fiduciary to act solely for the beneficiary’s benefit and that the fiduciary may have to forgo additional benefits, even if they come at no cost to the beneficiary); see also Flannigan, *supra* note 2, at 296 (stating that “the strictness of the fiduciary obligation is calculated to ensure not simply the diversion or non-maintenance of value but to promote the singular attentiveness of the fiduciary to the interests of the trusting party.”) (citation omitted).

222. See Brudney, *supra* note 1, at 624 (contrasting the exclusive benefit rule governing fiduciary relations to classic contractual arrangements where each party acts to benefit himself).

223. 45 U.S. 503 (1846).

224. *Id.* at 555.

225. *Id.*

226. *Id.*

benefit, then the fiduciary must be acting for the benefit of the principal.²²⁷ Similarly, in *Magruder v. Drury*,²²⁸ the Court held that the rule that a trustee cannot profit from his trust “springs from his duty to protect the interests of the estate.”²²⁹ The intention, the Court said, is to remove any self-interest “which can interfere with the faithful discharge” of the fiduciary duty.²³⁰

The duty of care, therefore, is akin to a legally enforceable imperfect duty.²³¹ Enforceability, however, is often difficult in duty of care cases.²³² It is left to the courts to determine after the fact whether the fiduciary has acted (or failed to act) in breach of the duty in a given case. Courts typically have applied the doctrine of negligence to establish when an action (or inaction) of a fiduciary results in breach.²³³ In the well-known formulation of the prudent man rule, Justice Putnam of the Supreme Judicial Court of Massachusetts in *Harvard College v. Amory*²³⁴ held that a trustee is required only to “observe how men of prudence, discretion and intelligence manage their own affairs.”²³⁵ This passage has given rise

227. One may respond that the fiduciary could be acting for the benefit of a third person—not the principal. But if the fiduciary acts to benefit a third person, the fiduciary presumably has an interest in benefiting the third person. The third person’s benefit, therefore, is tantamount to a benefit to the fiduciary, and acting in the third person’s benefit is therefore prohibited just as acting in self-interest is prohibited. Moreover, if the fiduciary acts to benefit a third person at the expense of the principal, such conduct would be harmful conduct toward the principal and prohibited by the duty of loyalty.

228. 235 U.S. 106 (1914).

229. *Id.* at 119.

230. *Id.*

231. Deborah DeMott has noted that judicial opinions in the fiduciary area are unique in their use of moral language to justify their outcomes. She ascribes this to the situation specific quality of the obligation as well as the stringency of the standards for assessing a fiduciary’s behavior and the high value placed on trust. DeMott, *supra* note 1, at 891-92. It may also be the case that judges use the sermonizing language to which DeMott refers because they recognize, at the deepest levels, that they are requiring the fiduciary by law to perform imperfect duties, which typically are not specified by law.

232. See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) (outlining the standards to prove a claim for breaching a duty of care); cf. Henderson, Jr. & Pearson, *supra* note 177, at 1434-35 (identifying nonverifiability and vagueness as problems in enforcing aspirational commands).

233. See Brudney, *supra* note 1, at 623 n.74 (stating, “Insofar as the fiduciary duty mandate embodies the duty of care, it may also be an objectionable example of state intrusion; but it does not impose a heavy obligation because it requires only the minimum acceptable level of performance rather than the maximum possible level.”).

234. 26 Mass. (9 Pick.) 446 (1830).

235. *Id.* at 461. In this case, a testator left \$50,000 to be invested by two trustees who also were executors of his estate. The executors invested the money in shares of stock and incurred losses. The appellants argued that the executors should have loaned the money for interest rather than investing in stock, which is relatively risky. *Id.* at 459-60. In his opinion, Justice Putman stated that the executors were to invest

to countless variations of a reasonableness standard that applies broadly to fiduciary relations. The Second Restatement of Trusts provides that the trustee must “exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.”²³⁶ One formulation of the standard of care for attorneys is that they must “exercise the skill and knowledge ordinarily possessed by attorneys under similar circumstances.”²³⁷ Leading corporate law cases provide that directors must use “that amount of care which ordinarily careful and prudent men would use in similar circumstances.”²³⁸ While courts employ several different standards of negligence, in each case the individual’s conduct is compared to how a reasonable person would have acted when faced with the same situation.²³⁹

This section has shown that the duty of loyalty and the duty of care differ in character. The duty of loyalty is primarily negative, while the duty of care is positive. The prohibitions required by the duty of

“according to their best judgment and discretion.” *Id.* at 465.

236. RESTATEMENT (SECOND) OF TRUSTS § 174 (2004); *see also* POMEROY, *supra* note 104, at § 1070 (stating, “The principle is well settled that trustees are bound to exercise care and prudence in the execution of their trust, in the same degree that men of common prudence ordinarily exercise in their own affairs.”). *See generally* RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE 227 (1992) (restating in one volume the rule governing the investment of trust assets and revising related rules concerning the conduct of a trustee).

237. 2 RONALD E. MALLEEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 18.2, at 551 (4th ed. 1996) (emphasis removed).

238. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963). *But see In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967-68 n.16 (Del. Ch. 1996) (stating that the negligence standard is inappropriate for directors because it encourages risk-averse behavior).

239. Duty of care cases distinguish between acting insufficiently, on the one hand, and not acting at all, on the other. Courts view the two differently and employ different standards of negligence depending on which is before them. *See, e.g., In re Caremark*, 698 A.2d at 967 (permitting the business judgment rule defense for board decision resulting from poor decision-making but not for “unconsidered failure of the board to act”) (emphasis removed); *Rabkin v. Philip A. Hunt Chem. Corp.*, No. CIV. A. 7547, 1987 WL 28436, at *2 (Del. Ch. Dec. 17, 1987) (contrasting the standard of liability of gross negligence for directors who undertake their responsibilities and the standard of ordinary negligence for directors who abdicate their responsibilities). Similarly, Kant reminded us that one should not mistake the notion of imperfect duty in one area as a license to shirk responsibility in others. Rather, the notion of imperfect—or wide—duty is that it may be limited only by another duty owed to others or to ourselves. Kant wrote, “But a wide duty is not to be taken as permission to make exceptions to the maxim of actions, but only as permission to limit one maxim of duty by another (e.g., love of one’s neighbor in general by love of one’s parents)” KANT, *supra* note 141, at 390; *see also id.* at translator’s n. 35. Kant distinguished between the failure to fulfill imperfect duties, on the one hand, and a transgression, or neglect of such duties, on the other. The former, he wrote, represents only a “deficiency of moral worth,” the latter a “vice.” *Id.* at 390. The difference between the failure to fulfill one’s duty of care and neglecting it entirely is reflected in corporate law cases analyzing directors’ duties of care.

loyalty are straightforward. By contrast, the actions required by the duty of care are open-ended. While the fiduciary's purpose or end must be the benefit of the principal, the actions taken to fulfill that end cannot be prescribed. While this discussion deepens one's understanding of fiduciary duties generally, it is critical to understand how courts resolve difficult cases of conflicts of duty.

III. RESOLVING CONFLICTS OF DUTY

Distinguishing between the nature of the duty of loyalty and the duty of care accounts for how courts resolve the conflicts discussed in Part I. Part II demonstrated that the duty of loyalty is generally negative and the duty of care is positive. The duty of loyalty is absolute and the duty of care is incremental. Thus, in cases of a conflict, the duty of loyalty would not permit exceptions to provide an incremental benefit to be obtained from adhering to the duty of care. The duty of loyalty prevails over the duty of care as the fiduciary first must "do no harm." Any benefit the fiduciary bestows upon the principal through positive acts is secondary. In the sections that follow, three areas of fiduciary law will be examined to show that courts apply these principles in their superintendence of fiduciary duties to settle conflicts between enforcing the duty of loyalty and the duty of care.²⁴⁰ The three areas are (i) attorney-client relationships; (ii) the responsibilities of financial advisers; and (iii) the duties of directors and trustees.

240. I shall not address situations where duties of loyalty conflict with one another or where duties of care conflict with other duties of care. Conflicting duties of loyalty seldom arise. As negative duties, they generally require inactions or omissions and rarely give rise to a conflict because the fiduciary should face no difficulty in performing any number of omissions at once. See JEREMY WALDRON, *Rights in Conflict*, in LIBERAL RIGHTS, COLLECTED PAPERS 1981-1991, at 203, 213-14 (1993) (describing how many traditional liberal rights, such as free speech or freedom of religion, are negative rights which should not conflict because they require the constrained not to act). An attorney, for example, should face no conflict in maintaining the confidentiality of multiple clients. As long as the attorney remains silent, he has not breached his duty of loyalty. Similarly, a financial adviser, like all fiduciaries, has a duty of loyalty to refrain from self-dealing. It should present no conflict for the fiduciary to omit from doing so.

Conflicting duties of care are ubiquitous and require the fiduciary to allocate scarce resources among multiple principals. Should an attorney spend her time preparing one case or another; should a financial advisor place a limited opportunity investment in the account of one client or another? While conflicting duties of care raise hard issues with regard to dividing scarce resources, they do not raise true conflicts where fulfilling the duty to one principal requires breaching the duty to another. See Henderson, Jr. & Pearson, *supra* note 177, at 1430 (discussing how aspiration, or the duty to act, only requires agents to act to the best of their abilities given the resources available to them and not to cease to act on everything else).

A. Attorneys and Clients

Attorneys representing multiple clients often face conflicts, such as determining whether to breach one client's confidentiality to promote the defense of a second. As mentioned in Part I, the Third Restatement of the Law Governing Lawyers addresses conflicts in multiple representation by requiring consent.²⁴¹ But consent in many cases may be difficult or impossible to obtain. Recall *Arizona v. Macumber*,²⁴² where the court, during Macumber's murder trial, opted to protect the confidentiality of a deceased client although the deceased's own attorneys were prepared to testify that the client had confessed to the same crimes of which Macumber was accused. Obtaining consent was not possible; the court had to resolve the conflict.

1. Loyalty and care

The analysis in Part II suggests that *Macumber* presents a classic dilemma between upholding the duty of loyalty or the duty of care. The duty of loyalty required the two attorneys representing the deceased to maintain his confidentiality.²⁴³ Every attorney knows that, absent consent by the client, an attorney generally has a duty to keep his clients' secrets.²⁴⁴ In *Macumber*, the attorneys' testimony would have resulted in a breach of confidentiality—a breach of the duty of loyalty.²⁴⁵ The duty of care, on the other hand, required Macumber's attorney to marshal evidence of his client's innocence. It is the attorney's duty to "present the client's case in the most favorable possible light."²⁴⁶ The amount of evidence the attorney must present is open-ended, but what better evidence to present than testimony that another person had confessed to the alleged crimes. The court resolved the conflict by preserving confidentiality (enforcing the duty of loyalty), even if it resulted in a less effective defense (inconsistent with the duty of care).

241. See *supra* note 70 and accompanying text.

242. 544 P.2d 1084 (Ariz. 1976).

243. See *In re Am. Airlines, Inc.*, 972 F.2d 605, 619 (5th Cir. 1992) (stating that the obligation of confidentiality to a client forms part of the lawyer's primary duty of loyalty); *Diversified Group, Inc. v. Daugerdas*, 139 F. Supp. 2d 445, 456 (S.D.N.Y. 2001) (characterizing the duty of loyalty and the duty of confidentiality as interconnected).

244. See MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2004) (stating that "[a] lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent").

245. See *supra* notes 32-37 and accompanying text.

246. *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984).

The decision in this case is remarkable for several reasons. First, the client to whom the duty of loyalty was owed was already dead. While death does not vitiate the attorney-client privilege at common law, when determining whether to uphold the privilege against countervailing interests, the fact that the holder of the privilege is deceased militates against preserving it at significant cost. Second, the deceased's attorneys were present in court and willing to waive the privilege on his behalf.²⁴⁷ While normally the privilege belongs to the client and is not the attorney's to waive, here the client was unavailable. Finally, the countervailing interests were significant because a potentially innocent person may have been convicted. Notwithstanding these considerations, the duty of loyalty trumped the duty of care.²⁴⁸

In *Macumber*, the court was presented with two fiduciaries owing duties to two principals. In most cases, a single fiduciary has multiple clients and is faced with a conflict between or among them. Practicing attorneys often are faced with such conflicts after their representation has commenced. An attorney, at the outset of a case, may envision no conflict in multiple representation and the clients may even consent to it. The emergence of a single piece of evidence, however, can lead to unforeseen dilemmas.²⁴⁹ Such conflicts often occur in ineffective assistance of counsel cases.²⁵⁰ Attorneys during trial may be forced to utilize or forgo a particular strategy or tactic that, while assisting one client, harms another. As a result, the non-prevailing party may claim, after the fact, denial of effective assistance of counsel.²⁵¹ In these cases, attorneys during the course of trial

247. *Macumber*, 544 P.2d at 1086.

248. See *supra* notes 32-37 and accompanying text.

249. This dilemma appeared briefly in the criminal trial of Martha Stewart for conspiracy to obstruct justice and obstruction of justice. See Superseding Indictment at ¶¶ 38, 55, *United States v. Stewart*, S1 03 Cr. 717 (S.D.N.Y. 2004), available at <http://news.findlaw.com/hdocs/docs/mstewart/usmspb10504sind.html> (last visited Jan. 31, 2005). In the underlying facts related to the criminal matter, one person allegedly tipped a second through a third party, but both the tipper and tippee denied that the tip occurred. The third party reportedly indicated after the start of the trial that the alleged tip came from someone other than the tipper. Such evidence, of course, would tend to exonerate the tipper, but it could implicate the tippee by showing she indeed received a tip, it just came from someone else. Highlighting the new evidence, therefore, could damage the tippee's case significantly. See Constance L. Hays, *Setback for Prosecutors in the Martha Stewart Trial*, N.Y. TIMES, Jan. 30, 2004, at C1 (stating, "The document is not likely to help Ms. Stewart, since it supports the notion that she received information that led to her stock trade. But it could lend weight to Mr. Bacanovic's argument that he did nothing wrong.").

250. See, e.g., *United States v. Moscony*, 927 F.2d 742 (3d Cir. 1991) (illustrating an ineffective assistance of counsel motion arising from multiple representation).

251. See RESTATEMENT OF THE LAW GOVERNING LAWYERS § 129 cmt. c (2000)

instinctively treat a breach of the duty of loyalty more seriously than a breach of the duty of care and tend to uphold the former even if it means breaching the latter.

This phenomenon became apparent in the criminal case *Glasser v. United States*.²⁵² In *Glasser*, William Stewart represented two defendants in a bribery trial.²⁵³ During the proceedings, several situations arose where Stewart was forced to decide between upholding the duty of loyalty to one client or the duty of care to the other, but not both.²⁵⁴ First, an accountant (Brantman) testified he acted as a conduit for the payment of a bribe to a defendant (Kretske), but Brantman said he did not know, and had nothing to do with, the second defendant (Glasser).²⁵⁵ The payer of the purported bribe (Abosketes) testified to the contrary that Brantman and Glasser were affiliated.²⁵⁶ Brantman was later recalled to the stand, but Stewart declined to question him, leaving the impression that Abosketes was correct and that Brantman was affiliated with Glasser.²⁵⁷ Stewart later told the court of his concern that his questioning would have elicited further damaging evidence against Kretske, and he believed that it was better to leave well enough alone.²⁵⁸ Cross-examination could have cast doubt on Abosketes's testimony and was necessary to develop Brantman's lack of knowledge about Glasser.²⁵⁹ The Court noted, "Stewart's failure to undertake such a cross-examination luminates the cross-purposes under which he was laboring."²⁶⁰ In addition to this incident, Stewart

(noting, "Witnesses who would be favorable to one defendant might be subject to cross-examination that would be unfavorable to another defendant. In closing argument, counsel must choose which facts to stress. For example, stressing the minor role of one defendant might imply the major role of another.").

252. 315 U.S. 60 (1941).

253. Two defendants, Glasser and Kretske, assistant United States attorneys in Chicago during the 1930s, were found guilty of conspiracy to defraud the United States. *Id.* at 63. The defendants solicited bribes from certain persons charged or about to be charged with violations of federal internal revenue laws relating to the sale of liquor. *Id.* at 64. Shortly before the start of trial, an attorney named William Scott Stewart entered his appearance for Glasser and the law firm of Harrington & McDonnell entered its appearance for Kretske. *Id.* at 68. On the day of trial, McDonnell informed the court that Kretske did not want McDonnell as his lawyer. *Id.* The judge, therefore, asked Stewart, Glasser's attorney, to represent Kretske as well. *Id.* at 68-69. After a discussion among the judge, Stewart, McDonnell, Kretske, and Glasser, the court appointed Stewart as attorney for Kretske, and Stewart represented both Glasser and Kretske throughout the trial. *Id.*

254. *Id.* at 72-77.

255. *Id.* at 72.

256. *Id.*

257. *Id.* at 73.

258. *Id.*

259. *Id.*

260. *Id.*

also failed to object to certain statements admissible as to Kretske, but not Glasser.²⁶¹ Glasser contended that the statements were inadmissible hearsay as to him and that Stewart failed to object on Glasser's behalf because the jury may have drawn a negative inference that the testimony was true as to Kretske.²⁶²

These are both examples of acts that Stewart could have taken in furtherance of his duty of care to Glasser. Taking these steps, however, would have harmed Kretske's defense and Stewart opted to stay silent.²⁶³ The Court recognized that the harm to Glasser was only incremental and found that "Stewart's representation of Glasser was not as effective as it might have been if the appointment had not been made."²⁶⁴ The Court confessed it is "difficult" to determine "the precise degree of prejudice sustained by Glasser as a result of the court's appointment of Stewart as counsel for Kretske."²⁶⁵ The breach of duty to Glasser, therefore, was in the nature of a breach of the duty of care.²⁶⁶ But had Stewart taken the steps discussed, he could have harmed Kretske. The potential breach of the duty to Kretske, therefore, was in the nature of the duty of loyalty. Stewart instinctively opted to preserve the duty of loyalty owed to Kretske, even though the result was a diminution in the quality of Glasser's defense.

2. *Acts and omissions*

The strategy and tactics deployed in *Glasser* also reflect the sentiment that one generally treats harm from *failing* to act more leniently than harm from *committing* an act. On both occasions, the attorney Stewart decided that he was better off by staying silent, even if that meant providing less effective representation for one, than by speaking and causing harm to the other.²⁶⁷ This strategy is consistent with the general perception that one ought to leave well enough

261. *Id.* at 74. Three witnesses testified that they heard Kretske make statements that Kretske would have to see "Red" or send the money to the "red-head," apparently a reference to Glasser, who had red hair.

262. *Id.*

263. *Id.* at 73-74.

264. *Id.* at 76.

265. *Id.* at 75-76.

266. In the end, the Court held that Glasser was denied effective assistance of counsel. *Id.* at 76. The Court recognized that the trial judge put Stewart in an untenable position and ordered a new trial as to Glasser. *Id.*

267. *See also* Flatt v. Super. Ct., 885 P.2d 950, 959 (Cal. 1994) (holding that a lawyer in a firm has no duty, when severing representation of one client, to advise him regarding contemplated lawsuit against another client of the firm).

alone by not taking any action that may make matters worse. The physicians' Hippocratic Oath begins, "Above all, do no harm."²⁶⁸

Why omissions are treated more leniently than acts, and whether such distinctions are appropriate or even possible, has been addressed in the context of criminal and tort law. In 1908, Francis Bohlen, upon whom William Prosser relied heavily in his classic treatise, wrote, "There is no distinction more deeply rooted in the common law and more fundamental than that between misfeasance and non-feasance, between active misconduct working positive injury to others and passive in action, a failure to take positive steps to benefit others."²⁶⁹ Bohlen recognized, however, that the difference between acts and omissions, while obvious in theory, can be difficult in practice. Bohlen maintained, "There is a borderland in which the act is of a mixed character, partaking of the nature of both."²⁷⁰ He wrote that the test of whether something is an act or omission is whether the victim is "positively worse off as a result."²⁷¹ In the case of an omission, the victim is "in reality no worse off at all . . . he is merely deprived of a protection which . . . would have benefited him."²⁷² In his book *Bad Acts and Guilty Minds*, Leo Katz more recently described the test as whether the harmful outcome would have occurred the way it did if the defendant did not exist.²⁷³

Professor Katz provides several reasons why omissions are treated differently from acts, which are relevant to fiduciary law. First, a rule prohibiting omissions (requiring acts), as opposed to a rule prohibiting commissions, is difficult to draft.²⁷⁴ This difficulty permeates the doctrine of the duty of care and, as discussed, courts have expressed that no specific set of rules can establish what the duty of care entails.²⁷⁵ Second, punishing omissions may be counterproductive because it could result in forbearance. As fiduciary duties become more robust, some argue, fewer individuals

268. *Oath of Hippocrates*, in HIPPOCRATIC WRITINGS (J. Chadwick & W.N. Mann trans., 1950), available at <http://www.med.umich.edu/irbmed/ethics/hippocratic-hippocratic.html> (last visited Jan. 17, 2004).

269. Francis H. Bohlen, *The Moral Duty to Aid Others as a Basis of Tort Liability*, 56 U. PA. L. REV. 217, 219 (1908), quoted in WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS 338-39 (1971).

270. *Id.* at 220, quoted in WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS (1971).

271. *Id.*

272. *Id.*

273. See LEO KATZ, *BAD ACTS AND GUILTY MINDS* 143 (1987) (recognizing limitations with this test and noting that counterfactual assumptions are inherently ambiguous and potentially contradictory).

274. *Id.* at 144.

275. See *supra* Part II.B.1.b.

will accept their responsibilities.²⁷⁶ Third, the consequences of an omission are more difficult to ascertain than those of an act. Assessing the consequences of an omission requires speculating as to what might have transpired had the act occurred; assessing the consequences of an act requires observing events that actually occurred.

A deeper reason why omissions are treated differently from acts focuses on individualism and personal autonomy. Bohlen wrote, "This distinction is founded on that attitude of extreme individualism so typical of anglo-saxon legal thought."²⁷⁷ A failure to act that results in harm is tantamount to failure to give up or to risk something the non-actor owns—time, money, safety—whereas acting that results in harm takes away something owned by the victim. Only the latter case violates our sense of personal autonomy. Similarly, prohibiting an act leaves the person free to perform any number of alternative acts—all acts except the prohibited one—whereas prohibiting an omission effectively requires the person to perform the single act the omission of which is prohibited. The latter is far more burdensome.²⁷⁸

The distinction between acts and omissions helps to explain why duties of *omission* trump duties of *commission*, and why duties of loyalty trump duties of care. The common law has been more willing to hold an actor responsible for an act than for a failure to act. As discussed, holding one responsible for an act which causes harm addresses a breach of the duty of loyalty. Holding one responsible for failing to act addresses a breach of the duty of care. To the extent that the law treats acts more seriously than omissions, it makes sense that the law treats a breach of the duty of loyalty more seriously than a breach of the duty of care.²⁷⁹

276. See, e.g., Claudia H. Deutsch, *The Higher Price of Staying Public*, N.Y. TIMES, Jan. 23, 2005, at BU5 (reporting that for many companies, burdens of operating registered public company after passage of Sarbanes-Oxley Act outweigh benefits); Tony Tassel, *Europeans Fall Out of Love with Listing in New York*, FIN. TIMES, Dec. 3, 2004, at 14 (reporting that Sarbanes-Oxley is causing many foreign companies to reconsider merits of listing in the U.S.); Richard A. Epstein, *Sarbanes Overdose*, NAT'L L.J., Jan. 27, 2003, at A17 (arguing that fewer persons are willing to serve as corporate directors after the passage of the Sarbanes-Oxley Act).

277. Bohlen, *supra* note 269, at 220.

278. See KATZ, *supra* note 273, at 144-45 (noting that removing one's autonomy and mandating action seems more offensive than simply prohibiting certain actions).

279. It is interesting to examine cases where courts set aside this rule and permit a breach of client confidentiality in the face of competing fiduciary duties. For example, in *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), the Court of Appeals for the Fifth Circuit focused on the common law doctrine known as the fiduciary exception to the attorney-client privilege. In that case, shareholders of a life insurance company brought a securities fraud class action against the company and certain of its officers, directors, and controlling shareholders. *Id.* at 1095. In the course of the lawsuit, the plaintiffs requested information from R. Richard

The Third Restatement of the Law Governing Lawyers confirms this approach.²⁸⁰ The Restatement on its face addresses conflicts of duty in multiple representation by requiring consent. It provides, “Unless all affected clients consent . . . a lawyer . . . may not . . . represent two or more clients.”²⁸¹ However, a closer look at the Restatement reveals an important qualifier and betrays the Restatement’s true concerns. The prohibition in civil and non-litigated matters, absent consent, applies only when the lawyer’s representation of one client would “materially and adversely” be affected by the duties to another client, or when the lawyer would represent one client against another client, even if in an unrelated matter.²⁸² The prohibition, therefore, is limited to situations where the attorney would take an action adverse to, or harming, a client in violation of his duty of loyalty. When noting the rationale for the rules, the Restatement reporters made plain the concern for “material and adverse consequences for the disadvantaged client” and the lawyer’s requirement “to remain loyal to clients and protect their confidential information.”²⁸³ Thus, while on its face the

Schweitzer, who was company counsel during the relevant time (although he later became the company’s president). *Id.* at 1096. The company’s subsequent counsel (at the time of the lawsuit) objected to the requests. *Id.* The new counsel argued that communications between Schweitzer and the company, which took place while Schweitzer was acting as counsel, were privileged. *Id.* In response, the shareholders argued that the privilege is not available to the company where the company’s shareholders are the very persons making the demand, and the lower court agreed. *Id.*

The court of appeals recognized that it was faced with competing interests of confidentiality and disclosure. *Id.* at 1100. The court opted for disclosure. It explained that the lawyer’s client here is the company itself and that the company functions for the benefit of the very same persons seeking the information. *Id.* at 1101. The court reasoned that management owes ultimate allegiance to the shareholders and should not be permitted to assert a privilege that would detract from their receiving information vital to their case. *Id.*

The court, however, appeared reluctant to hold that the shareholders’ right to information trumped the attorney’s duty of confidentiality. Instead, the court suggested that the ability to waive the privilege lay not with the company as an entity attempting to assert the privilege, but rather, with the collective of the shareholders. *Id.* at 1103-04. This suggestion is inconsistent with the view of many courts and commentators who insist that directors and officers owe duties to the corporation as an entity as well as to the corporation’s shareholders. See HENRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS §§ 231-232 (3d ed. 1983). The court tried to fit the attorney-client communication into traditional exceptions to the privilege but concluded it was unable to do so. *Garner*, 430 F.2d at 1102-03. Courts continue to apply the doctrine in a variety of fiduciary relationships. See, e.g., *Stenovich v. Wachtell, Lipton, Rosen & Katz*, 756 N.Y.S.2d 367, 376 (Sup. Ct. 2003) (collecting cases).

280. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 128 (2000).

281. *Id.*

282. *Id.* §§ 128, 130. In criminal cases, the rule is stricter due to constitutional concerns. *Id.* § 129.

283. *Id.* §§ 128 cmt. b, 130 cmt. b.

Restatement's approach to address conflicts among clients is to require consent, the Restatement is more concerned with violations of the duty of loyalty than with breaches of the duty of care.

B. *Financial Firms*

1. *The duty to disclose*

In cases involving conflicts of duty in financial firms, discussed above, courts hold that confidential information obtained by the firm from one client may not be disclosed to other clients of the firm.²⁸⁴ Thus, while customers may argue that a firm has a duty to disclose material information bearing on their investments even if the information is confidential, courts, some invoking a property theory, have ruled that the firms have a duty to protect the information. One court, *Cotton v. Merrill, Lynch, Pierce, Fenner & Smith*, concluded that between the two duties, the duty of confidentiality is undeniably more important.²⁸⁵ *Cotton* can be viewed as a conflict between upholding the duty of loyalty to the investment banking client by maintaining its confidentiality, on the one hand, and upholding the duty of care to investors by disclosing information to assist them in their investment decisions, on the other. The duty to maintain client confidentiality trumps the duty to disclose information to assist the firm's customers. The court held there was no affirmative duty to speak to the customers and quoted *Basic Inc. v. Levinson* for the proposition that silence, absent a duty to disclose, is not misleading.²⁸⁶ The firm in *Cotton* was not liable for failure to disclose the confidential information.

Similar cases are resolved differently if the financial firms take affirmative steps to mislead investors. If Merrill Lynch, for example, had advised investors to sell their shares when it knew the price would rise, that advice would have been tantamount to a misleading statement and a violation of the duty of loyalty. Such affirmatively misleading communications have been a flashpoint compelling a different outcome in other cases. Recall *Black v. Shearson, Hammill & Company*.²⁸⁷ Shearson Hammill was touting the stock of a company while a Shearson partner sat on the company's board and knew it was

284. *Cotton v. Merrill, Lynch, Pierce, Fenner & Smith*, 699 F. Supp. 251 (N.D. Okla. 1988).

285. *Id.* at 256 (quoting *In re Cady, Roberts & Co.*, Exchange Act Release No. 6668, 40 SEC Docket 907, 916 (Nov. 8, 1961)).

286. *Id.* (quoting *Basic Inc. v. Levinson*, 485 U.S. 224 (1988)).

287. 72 Cal. Rptr. 157 (Ct. App. 1968).

faltering.²⁸⁸ When asked about the company's prospects, the partner suggested it was performing well, and he failed to provide the complete picture.²⁸⁹ When Shearson was challenged, it responded that the partner did not know his statements were false when he made them, and that in any case he had a fiduciary duty to the issuer not to reveal confidential information.²⁹⁰ But the court found culpability in *Black* because the individual realized subsequently that his previous statements were false.²⁹¹ He "permitted them to stand after he learned the truth and before respondents relied on them. His knowledge and approval of the statements, accompanied by his knowledge of the truth about [the issuer], were elements in a continuing course of conduct."²⁹² The court ruled the firm had a duty of disclosure to its investor clients and upheld punitive damages against the individual because he acted with malice.²⁹³

The SEC has reached similar conclusions in cases with similar facts. In one case, *Van Alstyne, Noel & Co.*,²⁹⁴ the SEC was required to determine if a broker-dealer should be sanctioned for making positive statements about a company when the broker possessed material negative non-public information about the company as a result of an underwriting relationship.²⁹⁵ The broker argued it was under no duty to disclose negative information to its customers because, among other reasons, the information was confidential.²⁹⁶ The SEC disagreed, stating that once the broker released positive information about the company, it had a duty to disclose negative

288. *Id.* at 159.

289. *Id.*

290. *Id.*

291. *Id.* at 160.

292. *Id.* Courts before and after this case have recognized liability where the defendants have failed to correct prior statements. Such cases typically find liability under the "duty to correct" doctrine, where the defendants learn after making the statements that they were false. This doctrine is occasionally confused with a "duty to update," which is a duty to revise statements that, while true when made, became false or misleading over time. For a discussion of these doctrines, see *Int'l Bus. Mach. Corp. Sec. Litig.*, 163 F.3d 102, 109 (2d Cir. 1998), *Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1430-33 (3d Cir. 1997), and COX ET AL., *supra* note 19, at 750-52.

293. *Black*, 72 Cal. Rptr. at 162.

294. Exchange Act Release No. 4699, 33 SEC Docket 311 (Apr. 8, 1952).

295. Van Alstyne acted as both broker and dealer in the shares of Expreso Aereo Inter-Americano, S.A., and as an underwriter for an offering of the company's shares. *Id.* at 312-13. As a result, Van Alstyne had information indicating that Expreso was operating at increasing losses. *Id.* at 313. Nevertheless, Van Alstyne made optimistic statements to other dealers in Expreso stock about the company's prospects, including that "the situation looked 'very good' and [that] the company could show 'black figures' when one or two planes were put in operation." *Id.* at 313-17. Van Alstyne also made similar statements to private investors. *Id.* at 332-36.

296. *Id.* at 334.

information as well.²⁹⁷ The firm should have simply refrained from making statements regarding the company's prospects. The SEC wrote, "Having chosen to continue to effect transactions in [the] stock, registrant should have refrained from making any statements which would be rendered misleading by the failure to disclose such financial information."²⁹⁸ Once it "volunteered optimistic information" about the company's prospects, "it was bound also to disclose at least generally the extent and trend of [the company's] losses."²⁹⁹

2. *Tort law*

The reasoning in these cases is consistent with traditional tort doctrine of the duty to render assistance to others. Under the old common law rule, one does not have a Good Samaritan duty to voluntarily render aid to others.³⁰⁰ If one places another in danger, or exposes him to hardship, however, then one has a duty to keep the risk from materializing into harm. The owner of a bar, for example, was liable for expelling an intoxicated customer, who became drunk on the premises, after the customer died from exposure to the elements.³⁰¹ Similarly, a business host was liable to his guest when the guest took ill and the host refused him permission to spend the night and placed him, helpless, in his horse-drawn sleigh, from which he fell and was injured.³⁰² In his treatise, Prosser wrote that "if the

297. *Id.* at 321. The Commission stated,

[W]hen registrant disseminated favorable and optimistic information with respect to Expreso's condition and prospects, it made itself subject to an overriding duty of disclosure to its customers. Registrant should have appreciated that giving to a customer favorable or optimistic information and withholding unfavorable information which it considered confidential would be misleading and unfair to the customer.

Id.

298. *Id.*

299. *Id.* It was no excuse that the broker-dealer actually believed the company's long-term prospects were good. The opinion stated,

[E]ven assuming that it was reasonable for registrant to believe until that time that Expreso had a bright future, registrant nevertheless owed a duty to its customers, with whom it was dealing and to whom optimistic statements were made, to disclose Expreso's deteriorating financial condition and also, perhaps, that previous optimistic statements had not materialized.

Id. at 324 (footnote omitted).

300. *See* *Union Pac. Ry. Co. v. Capier*, 72 P. 281, 283 (Kan. 1903) (noting that, while the "moral law" mandates that one must rescue a person in danger, the "law of the land" does not require such action); *see also* WILLIAM L. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 340 (1971) (stating that "the law has persistently refused to recognize the moral obligation of common decency and common humanity, to come to the aid of another human being who is in danger, even though the outcome is to cost him his life").

301. *Weymire v. Wolfe*, 3 N.W. 541, 543 (Iowa 1879).

302. *Depue v. Flateau*, 111 N.W. 1, 2 (Minn. 1907).

defendant's own negligence has been responsible for the plaintiff's situation, a relation has arisen which imposes a duty to make a reasonable effort to give assistance, and avoid any further harm."³⁰³

Traditional tort doctrine demonstrates why *Black* and *Van Alstyne* were decided differently from *Cotton*. In *none* of the three cases—*Black*, *Van Alstyne*, or *Cotton*—could the firm breach its duty of confidentiality, but in *Cotton*, the firm was not culpable for failing to disclose the confidential information to investor clients, whereas in *Black* and in *Van Alstyne* the firms were liable. The key difference is that in *Black* and *Van Alstyne*, the firms took positive acts to place the customers in peril—they made affirmative misstatements to them—whereas in *Cotton*, the firm simply failed to speak; the employees remained silent and offered no advice on matters about which they had confidential information.³⁰⁴ This case demonstrates that, when upholding a duty of loyalty to one person (preserving confidentiality), one may not breach a duty of loyalty (affirmative misstatements) to another. As the Supreme Court has stated, "Lying is inconsistent with the duty of loyalty owed by all fiduciaries."³⁰⁵ But one may uphold one's duty of loyalty by preserving confidentiality even if it means not acting in accordance with one's duty of care by disclosing relevant information. In that sense, *Cotton* echoes *Arizona v. Macumber*³⁰⁶ regarding the duty of confidentiality to the deceased. When forced to resolve a conflict, courts uphold the duty of loyalty if the result is merely a breach of the duty of care.

The result in these cases is consistent with the distinction between perfect and imperfect duties discussed in Part II. One must always fulfill a perfect duty even if it results in a breach of an imperfect duty. But one may not breach a perfect duty and claim that doing so was necessary to fulfill another perfect duty.³⁰⁷ If questioned on a matter

303. PROSSER, *supra* note 300, at 342.

304. See Note, *Conflicting Duties of Brokerage Firms*, 88 HARV. L. REV. 396, 403 (1974) (noting that *Black* and *van Alstyne* imposed liability on the broker without taking into consideration that he had a duty to his investors).

305. *Variety v. Howe*, 516 U.S. 489, 506 (1996).

306. 544 P.2d 1084 (Ariz. 1976).

307. The RESTATEMENT (SECOND) OF AGENCY is consistent with this proposition. A comment to section 381 provides:

[I]t is normally understood that [an agent] is not to communicate to the principal any information which he already has, or which he acquired during the performance of the agency, the disclosure of which to the principal would be a breach of duty to a third person, as when an attorney, having acquired confidential information from a client, is subsequently employed by another client to conduct a transaction in which the information is relevant. If the attorney cannot perform his duty to the second client without disclosing such information or using it to the disadvantage of the first, he should decline to act.

about which one has confidential information, one must remain silent. If the truth calls for breaching confidentiality, the only option is to say nothing at all.

But is this explanation consistent with *Tarasoff v. Regents of the University of California*?³⁰⁸ The court in *Tarasoff* held that the confidentiality of the patient-psychotherapist relationship must yield to prevent a threatened danger to another.³⁰⁹ Prosenjit Poddar told his therapist in no uncertain terms that he was going to kill Tatiana Tarasoff.³¹⁰ The threat presented a clear and specific danger to Tarasoff, so much so that the therapist contacted campus police and decided Poddar should be committed for observation.³¹¹ The key point in *Tarasoff* is the court held that the legislature provided for an exception, in advance, to the patient-psychotherapist privilege. Under the circumstances, the privilege simply did not exist. The court quoted both the relevant statute as well as rules of professional ethics to show not that the duty of confidentiality was breached and that the breach was justified, but rather that no duty of confidentiality existed in the first place.³¹² Recall it is not the case that perfect duties permit no exceptions. Rather, they permit no exceptions in the interest of inclination asserted as an afterthought. A prohibition, like in *Tarasoff*, may be subject to limiting conditions contained in the law itself.³¹³

3. Omissions and acts

Another way of looking at these cases is that they turn on the difference between acts and omissions.³¹⁴ The law generally treats omissions more leniently than acts. In *Black* and *Van Alstyne*, the firms made misleading statements about the prospects of particular companies, while in *Cotton*, the firm merely refrained from acting. Even in *Tarasoff*, the victim's parents alleged certain affirmative conduct in addition to the failure to warn. While Poddar's therapist first sent a letter to the police requesting assistance in securing

RESTATEMENT (SECOND) OF AGENCY § 381 cmt. e (1958).

308. *Tarasoff v. Regents of Univ. of Cal.*, 551 P.2d 334 (Cal. 1976).

309. *Id.* at 347.

310. *Id.* at 339.

311. *Id.* at 341.

312. *Id.* at 347.

313. See *supra* note 145 and accompanying text (explaining that conditions are often formulaic in prohibitions).

314. Generally, the distinction between acts and omissions may not be salient for fiduciaries, who have a duty to be candid. DeMott, *supra* note 1, at 906. This distinction is important, however, when attempting to resolve conflicts of duties among principals.

Poddar's confinement, the director of psychiatry subsequently took action by asking the police to return the letter and destroy any copies, and by ordering no action be taken to place Poddar in treatment.³¹⁵

The distinction between acts and omissions, however, as Professor Bohlen noted long ago, is often difficult in practice.³¹⁶ In *Black*, the individual partner may have believed his statements were true when he made them. That fact is important because one could argue that he did not act inappropriately at all, but rather that he was guilty only of the sin of omission when he failed to revise his earlier statement once he realized that it was untrue. Under that reasoning, he is no longer guilty of an act but rather an omission. The act-omission distinction raises similar questions in *Van Alstyne*. In that matter, the SEC's view was not that the firm had repeated a false statement, but rather that the firm provided certain favorable information about the company while withholding unfavorable information. Looked at in this way, the firm was guilty of an omission, not an act.

So is it possible to characterize these omitted statements as acts? Courts have held that, while one does not have a generalized duty to disclose all material information, once a person has revealed some relevant information, further silence or failure to disclose a relevant material fact is prohibited.³¹⁷ The federal securities laws prohibit a material omission as well as a misstatement, but only if the omitted act is necessary to make a previous statement not misleading.³¹⁸ A duty to disclose—to “speak the full truth”—arises only after the speaker undertakes to act.³¹⁹ As mentioned, “Silence, absent a duty to disclose, is not misleading.”³²⁰ In state corporate law, an obligation to disclose all material facts arises once a director voluntarily undertakes

315. *Tarasoff*, 551 P.2d at 341.

316. See *supra* note 270 and accompanying text.

317. See generally *First Va. Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977) (noting that a duty to disclose the whole truth begins when a fiduciary chooses to reveal relevant information); *Grossman v. Waste Mgmt., Inc.*, 589 F. Supp. 395, 409 (N.D. Ill. 1984) (stating, if a company “chooses to reveal relevant, material information even though it had no duty to do so, it must disclose the whole truth.”).

318. See, e.g., Securities Act § 17(a), 15 U.S.C. § 77q(a) (2000) (prohibiting obtaining money or property “by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made . . . not misleading”). Similarly, under Rule 10b-5, it is unlawful “to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.” Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2002). See generally Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 STAN. L. REV. 87, 94 (1999) (arguing that prohibiting half-truths, like prohibiting outright fraud, is efficient).

319. *First Va. Bankshares*, 559 F.2d at 1317.

320. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1987).

to make disclosures.³²¹ Similarly, in tort law, taking a gratuitous affirmative act to assist a person in need may create a new duty to provide the assistance needed in the first place. According to the Second Restatement of Torts, if a bystander initiates a rescue attempt, the bystander cannot leave the victim in a worse position than when the rescuer took charge.³²² Thus, providing incomplete disclosure may be viewed as an act, putting the recipient of the information in a worse position than if the partial disclosure had never been made.³²³ *Tarasoff* is analogous. While *Tarasoff* is considered a failure to warn case, the acts taken by the director of psychiatry—the order to destroy the therapist’s letter and the order to take no action to place Poddar in a treatment facility—may well have placed Tatiana in even more peril than she was in before those acts occurred.

4. *Information barriers*

A final point regarding financial firms is that they now often are required to structure themselves, through the use of barriers to the flow of information—sometimes referred to as “Chinese Walls”—to ensure they do not breach the duty of loyalty, even if the structure results in a diminution of the duty of care.³²⁴ To address concerns

321. See, e.g., *Ciro, Inc. v. Gold*, 816 F. Supp. 253, 266 (D. Del. 1993) (“[O]nce directors voluntarily undertake to make certain disclosures to the stockholders, they are obligated, under the so-called duty of complete candor, to disclose all material facts.”); *Kahn v. Roberts*, Civ.A.No. 12,324, 1994 WL 70118, at *2 (Del. Ch. Feb. 28, 1994) (asserting that the duty of full disclosure attaches to directors once they voluntarily decide to disclose information relevant to a corporate transaction), *aff’d*, 679 A.2d 460 (Del. 1996).

322. RESTATEMENT (SECOND) OF TORTS § 324 (1965); see also PROSSER, *supra* note 300, at 343 (“If there is no duty to come to the assistance of a person in difficulty or peril, there is at least a duty to avoid any affirmative acts which make his situation worse.”).

323. The case law deciding conflicts of duty supports that an omission can be considered an act when a recommendation to purchase is made while in possession of non-public information not disclosed. See *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (noting that when a recommendation is made, the salesman implies that he has conducted research into essential information relating to the security). The court continued, “Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.” *Id.* See also *Slade v. Shearson, Hammill & Co.*, Fed. Sec. L. Rep. (CCH) ¶ 94,329 (S.D.N.Y. Jan. 2, 1974). The SEC agreed with the Court’s ruling in *Slade*. See Brief for SEC as *amicus curiae*, *Slade v. Shearson, Hammill & Co.*, No. 74-1537 (2d Cir., appeal allowed April 19, 1974) (“Rule 10b-5 prohibits a recommendation contrary to facts about the security in question known by the broker-dealer”); Lawrence A. Hammermesh, *Calling Off the Lynch Mob: The Corporate Director’s Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1167-68 (1996) (discussing the difference between the affirmative duty of disclosure and the avoidance of material misstatements or omissions).

324. See Christopher M. Gormam, Note, *Are Chinese Walls the Best Solution to the Problems of Insider Trading and Conflicts of Interest in Broker-Deals?*, 9 FORDHAM J. CORP. & FIN. L. 475, 486-87 (2004) (stating that the SEC believes that Chinese Walls are both

about disclosure of confidential information, financial firms developed compliance mechanisms to prevent the flow of non-public information from one part of the firm to another. Thus, while preserving the confidentiality of certain clients, the firms may fail, inconsistent with the duty of care, to provide important information to others. The SEC encouraged the use of such procedures as early as 1968 in a settled administrative proceeding with Merrill Lynch.³²⁵ The use of these procedures was formalized in 1980 when the SEC adopted a rule to address insider trading in the context of tender offers.³²⁶ In adopting the rule, the SEC recognized that, while protecting confidentiality, the procedures might result in an incremental decrease in the benefits to certain customers:

These present practices include the use of so-called 'Chinese Walls' which are used to isolate the nonpublic flow of information from one department to the rest of the institution. Depending on the circumstances, it may be appropriate to advise customers of its use of the Chinese Wall, because the institution would not be using all information that it had received to the benefit of a particular customer.³²⁷

A new insider trading rule, Rule 10b5-1, parrots the language of the tender offer rule. The rule addresses when a purchase or sale is considered "on the basis of" material non-public information for insider trading purposes. The rule provides that a firm may demonstrate that a purchase or sale was not "on the basis of" inside information if, among other things, the firm has such information barriers in place.³²⁸ In April 2003, these procedures were included as

important and necessary in financial firms).

325. *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,629 (Nov. 25, 1968). In that matter, the SEC staff alleged that insider trading principles prohibited the disclosure of non-public information to favored customers who may sell their shares before the information is publicly disclosed. *Id.* The Commission stated that in determining to settle the proceedings, it considered the firm's undertaking to implement procedures to prohibit disclosure of material information obtained from a client but not yet disclosed to the public. *Id.* at 83,350.

326. The tender offer rule generally requires any person to disclose-or-abstain if in possession of material non-public information regarding a tender offer, and if the information was obtained from the person making the offer, the company whose securities are to be sold, or anyone acting on their behalf. Transactions in Securities on the Basis of Material, Nonpublic Information in the Context of Tender Offers, 17 C.F.R. § 240.14e-3(a) (1980). But the SEC provided an exception from the disclose-or-abstain rule if the person making the investment decision did not actually know of the non-public information and if the firm implemented procedures to prevent the person from knowing the information. 17 C.F.R. § 240.14e-3(b).

327. Tender Offers, Securities Act Release No. 6239, 45 Fed. Reg. 60410, 60415 (Sept. 12, 1980).

328. Exchange Act Rule 10b5-1, 17 C.F.R. § 240.10b5-1 (2004); *see also* Selective Disclosure and Insider Trading, Securities Act Release No. 7881 (Aug. 15, 2000)

part of a global settlement of enforcement actions against ten large firms alleging that investment banking departments exercised improper influence over research departments to curry favor with certain clients and generate investment banking business.³²⁹ Thus, the decision to resolve the conflict between preserving confidentiality, consistent with the duty of loyalty, and promoting disclosure, consistent with the duty of care, has been resolved in favor of the duty of loyalty through compliance procedures sanctioned by the courts and the SEC.

C. Trustees and Directors

1. ERISA trustees

The principles applied to resolve conflicts of duty in financial firms apply equally to trustees who also serve as company officers and directors. A good example is section 408(c)(3) of ERISA, which allows an “officer, employee, agent, or other representative” of a company employer also to serve as a trustee for the company’s pension or employee benefit plan.³³⁰ ERISA provides that plan fiduciaries must discharge their duty “solely in the interests of the participants and beneficiaries.”³³¹ When the same plan fiduciary, however, also serves as an officer or director, and therefore as a fiduciary to the company shareholders (and the company itself), conflicts inevitably arise.³³²

(adopting Rule 10b5-1 and stating that, “we derived this provision from the defense against liability codified in Exchange Act Rule 14e-3, regarding insider trading in a tender offer situation.”).

329. The settlements contain undertakings stating, “Research and Investment Banking will be physically separated. Such physical separation will be reasonably designed to prevent the intentional and unintentional flow of information between Research and Investment Banking.” See, e.g., Final Judgment as to Defendant Bear Stearns & Co. Inc., Addendum A, Undertaking I.4, SEC v. Bear, Stearns & Co., Inc., No. 03 Civ. 2937 (WHP) (S.D.N.Y. Oct. 31, 2003), available at <http://www.sec.gov/litigation/litreleases/finaljudgadda.pdf>. The settlements were subsequently approved. See SEC v. Bear, Stearns & Co., Inc., No. 03 Civ. 2937 (WHP) (S.D.N.Y. Oct. 31, 2003) (order approving consent judgments), available at <http://www.sec.gov/litigation/litreleases/judge18111.pdf>; see also *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 640 n.77 (S.D. Tex. 2002) (explaining that financial institutions are required to erect a “Chinese Wall” between its research department and its divisions providing commercial banking, underwriting, or other services to issuers of securities to prevent information from the latter influencing the former).

330. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (2004).

331. 29 U.S.C. § 1104(a)(1)(B).

332. See Daniel Fischel & John H. Langbein, *ERISA’s Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1126-28 (1988) (stating that ERISA’s use of nonneutral fiduciaries creates an obvious tension with the duty of loyalty that is preserved in the exclusive benefit and prohibited transaction rules).

This issue was litigated after the fall of Enron Corporation.³³³ Employees who participated in three employee pension benefit plans, governed by ERISA, alleged that committees, trustees, and individuals administering the plans, many of whom were individual officers and directors of Enron, breached their fiduciary duties under ERISA.³³⁴ The plaintiffs alleged that the defendants breached their duty of loyalty to the plan participants by misleading them about Enron's financial condition while inducing them to hold and purchase Enron stock.³³⁵ The plaintiffs also alleged that the defendants had a fiduciary duty to disclose Enron's financial condition to the plan participants and beneficiaries.³³⁶

Certain defendants, who served in the dual capacity of plan administrator and company director, argued they faced a conflict. The defendants urged that if they disclosed to the plan participants non-public information about financial improprieties at the company, they would violate federal insider trading laws.³³⁷ As the court explained, Rule 10b-5 requires a corporate insider because he owes a fiduciary duty to shareholders to either disclose material non-public information or abstain from trading.³³⁸ Moreover, if a plan fiduciary were to tell plan participants about Enron's true financial condition so that they could sell at a high price before the information became public, the plan fiduciary could be considered to have illegally "tipped" the plan participants, which violates insider trading law.³³⁹ The directors, in essence, argued they should not be forced to violate the duty of loyalty owed to the company, by breaching its confidentiality, to further the duty of care owed to the plan participants by encouraging them to sell at a high price.

Judge Harmon remarked, "The fiduciary's duty to disclose is an area of developing and controversial law."³⁴⁰ In her ruling, she emphasized that the plaintiffs were suffering ongoing harm as a result of illegal activity at Enron, and the failure to disclose information about accounting irregularities and financial improprieties "would only serve to make the harm more

333. *In re* Enron Corp. Sec. Derivative & ERISA Litig., 284 F. Supp. 2d 511 (S.D. Tex. 2003).

334. *Id.* at 530.

335. *Id.* at 555.

336. *Id.*

337. *Id.* at 563.

338. *Id.* at 564 (discussing the Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1951), and citing *Chiarella v. United States*, 445 U.S. 222, 226-29 (1980)).

339. *Id.*

340. *Id.* at 555.

widespread.”³⁴¹ This was not a case where silence would simply preserve the *status quo*. The company had gone too far down a path of financial chicanery for the directors to argue they could remain silent and still do no harm. The court explained that “continued silence and deceit would only encourage the alleged fraud and increase the extent of injury.”³⁴²

In ruling that the plaintiffs could survive a motion to dismiss, the court emphasized the defendants’ acts and not their omissions. The plaintiffs stated a claim for breach of fiduciary duty “based on Defendants’ alleged *inducement* of the plan participants to direct the trustee to invest in Enron stock.”³⁴³ The failure to disclose material information about accounting malfeasance was coupled with insiders selling their own shares, “while contemporaneously and repeatedly exhorting plan participants and beneficiaries at meetings and by e-mail to buy more.”³⁴⁴ Thus, the *Enron* case is a further illustration that, while one must act in accordance with the duty of loyalty even if it results in a diminution in care, one may not uphold the duty of loyalty to one principal if the result is a breach of the duty of loyalty to another. As the court noted, one may not “both breach his duty under ERISA and, in violation of the securities laws, become part of the alleged fraudulent scheme to conceal Enron’s financial condition to the continuing detriment of current and prospective Enron shareholders.”³⁴⁵ While the defendants tried to argue that they sought to uphold their duty of loyalty owed to Enron, even if that resulted in a breach of the duty of care to the plan participants, the court determined that the breach of duty to the plan participants was in the nature of the duty of loyalty and would not be allowed.

The conflict of duty faced by pension trustees who also serve as officers and directors is often crystallized during an attempted takeover. In that context, plan assets may be a tool to help management stave off an unwanted bidder, although using plan assets in this way may harm the plan participants. A leading case analyzing the conflict raised by these dual roles is *Donovan v. Bierwith*.³⁴⁶ In the fall of 1981, LTV Corporation made a tender offer for seventy percent of the outstanding stock and convertible securities of Grumman Corporation.³⁴⁷ At the time, the Grumman

341. *Id.* at 565.

342. *Id.*

343. *Id.* at 656.

344. *Id.* at 657.

345. *Id.* at 565.

346. 680 F.2d 263 (2d Cir. 1982).

347. *Id.* at 264.

corporate pension plan owned 525,000 shares of Grumman stock.³⁴⁸ Grumman officers, including John Bierwith, the chairman, and Robert Freese, the chief financial officer, were trustees for the plan.³⁴⁹ As part of their strategy to avoid a takeover, the plan trustees voted not to tender the plan's 525,000 shares at \$45, and considered the merits of purchasing additional shares, on behalf of the plan, which were trading in the \$30s.³⁵⁰ One benefit of the purchase would have been to make it more difficult for LTV to gain control. The trustees decided to purchase Grumman stock up to the maximum of ten percent of the value of the plan allowed by ERISA and obtained the shares for between \$36 and \$39.³⁵¹ Shortly after the purchase, a district court enjoined the offer and the price of stock fell to between \$28 and \$30.³⁵²

Judge Friendly's decision makes plain the classic dilemma these individuals faced between upholding the duty of care to the corporation or the duty of loyalty to the plan beneficiaries. According to the court, the officers "were caught in a difficult and unusual situation" and were "honestly convinced" they were doing the right thing.³⁵³ The officers argued that despite their duty to act solely and exclusively in the interest of the plan participants, they "do not violate their duties by following a course of action with respect to the plan which benefits the corporation as well as the beneficiaries."³⁵⁴ Judge Friendly recognized, however, that from the plan participants' perspective, purchasing additional shares "was almost certainly a 'no-win' situation."³⁵⁵ If the tender offer succeeded, the plan would be a minority stockholder in an LTV-controlled Grumman, and if the tender offer failed, the price of Grumman shares would likely sink to their pre-offer level, as the trustees were aware.³⁵⁶ As the court put it, "Mid-October 1981 was thus the worse possible time for the Plan to buy Grumman stock as an investment."³⁵⁷

The difference between the duty of loyalty and the duty of care—between acts and omissions—accounts for Judge Friendly's ruling. While the officers were trying to benefit the company as a whole, consistent with their duty of care, they could not do so through

348. *Id.*

349. *Id.*

350. *Id.*

351. *Id.* at 269.

352. *Id.*

353. *Id.* at 276.

354. *Id.* at 271.

355. *Id.* at 275.

356. *Id.*

357. *Id.*

actions that affirmatively harmed the plan participants in violation of the duty of loyalty. The officers, at least with respect to the plan, should have simply refrained from acting. The court noted, “Investment considerations dictated a policy of waiting.”³⁵⁸ By taking actions to harm the plan participants, even if well-intentioned, the officers violated their duty of loyalty and failed to measure up to the standards required under ERISA.

2. *Common law trustees*

The cases regarding common law trustees discussed in Part I of the Article can now be understood as upholding the duty of loyalty over the duty of care. Recall *Rosencrans v. Fry*.³⁵⁹ In that case, Fry served in two capacities that led to a conflict of duty. He served on a company’s board, owing duties to the company and the shareholders, and he served as trustee for a trust that invested in the same company, owing a duty to the trust beneficiaries.³⁶⁰ Serving in these roles does not necessarily lead to a conflict, but in this case, the testator’s wife, Lee, asserted that Fry breached his fiduciary duty to the beneficiaries by failing to cause the company to declare a larger dividend during the period after the testator’s death.³⁶¹ Fry opted instead to reinvest the earnings in the company’s operations.³⁶²

The conflict over whether to declare the enhanced dividend is another example of the classic conflict between upholding the duty of loyalty or the duty of care—between refraining from taking an action that would harm one principal, although the action would assist, incrementally, a second principal. Declaring the dividend would have provided the beneficiaries with an incremental benefit, and Fry was arguably required to do so consistent with the duty of care. Declaring the dividend, however, would have harmed the company in breach of the duty of loyalty by depleting assets that could be used for business purposes.

When the court decided the case, it framed the issue as a conflict between promoting the interests of the beneficiary, on the one hand, and harming the corporation, on the other. The court stated that Fry’s duty “does not embrace a duty to advance the interest of the beneficiary at the expense of the corporation and other outstanding stockholders’ interests.”³⁶³ The harm to the company from a

358. *Id.*

359. 91 A.2d 162 (N.J. Super. Ct. Ch. Div. 1952).

360. *Id.* at 163.

361. *Id.* at 164-65.

362. *Id.* at 167.

363. *Id.* at 168.

declaration of dividends (acting “at the expense of the corporation”) would have amounted to a breach of the duty of loyalty. The incremental benefit to the beneficiaries (acting “to advance the interest of the beneficiary”) would only further the duty of care.

The court could have ruled in favor of Lee had it considered this case a dilemma between upholding the rights of a trust beneficiary versus the rights of company shareholders. Alternatively, the court could have viewed the director’s duty to the company to not declare a greater dividend as part of the duty of care, that is, to advance the interests of the company by enhancing the residual value of the firm. But the court’s analysis was more nuanced. It recognized the case as a conflict between harm to one principal only to promote, incrementally, the benefits to a second, and it would not permit the harm to occur. Fry was better off not acting at all than acting to harm the company.

Accordingly, one also may also view this case as turning on the difference between acts and omissions. The gist of the opinion is that Fry merely omitted to act to Lee’s benefit; he simply did not cause the company to declare the dividend she sought. He was better off not acting, which, while not furthering Lee’s interests, at least did no harm. But the line between acts and omissions is not always clear.³⁶⁴ Viewing the case as hinging on the difference between acts and omissions ignores the fact that Fry acted when he declared a dividend, but the dividend was simply too meager for Lee. One could view Fry’s conduct, therefore, not as an omission, but as an act injurious to Lee. In that sense, the nature of the breach could be recharacterized as a breach of the duty of loyalty to Lee and not a breach of the duty of care.³⁶⁵

But this argument is ultimately unpersuasive. Lee’s claim is most simply unmasked as a claim for a larger dividend, not a claim that Fry took an affirmative act to her detriment. After all, some benefit is better than no benefit at all; a small dividend is better than none. This case likely would have been decided differently if the trustee had taken steps to affirmatively harm the beneficiaries. The plaintiff alleged only that the trustee failed to declare larger dividends to assist the beneficiaries, not that he took positive steps to harm them.³⁶⁶

364. See *supra* note 270 and accompanying text.

365. Leo Katz’s test for what is an act as opposed to an omission—whether the harmful outcome would have occurred the way it did if the defendant did not exist—is not helpful here because one has no way of knowing the amount of dividend the company would have declared, if any, if Fry did not exist. See *supra* note 273 and accompanying text.

366. This outcome is also supported by the result in *Siskind v. Sperry Ret. Program*,

In *Shanley's Estate v. Fidelity Union Trust*,³⁶⁷ also discussed in Part I, an individual in a similar role took steps that harmed the beneficiaries of a trust, while promoting the interests of a company on which he served as a director.³⁶⁸ In that case, a trust company was a fiduciary to an estate that held shares of a subsidiary company.³⁶⁹ Certain board members of the trust company also sat on the board of the subsidiary's parent company while the parent sought to acquire shares held by the trust.³⁷⁰ The beneficiaries, however, made plain their wishes not to sell, and the court ruled that, when faced with a conflict, the trustee should not have acted against the wishes of the beneficiaries.³⁷¹ As the court put it, "their wish should be our trustee's command."³⁷² Thus, while one could view *Shanley's Estate* as a conflict between a seller whose interest is to sell dear and a buyer whose interest is to buy cheap, it is more plainly viewed as a conflict between the duty of care to purchase shares on the parent company's behalf at the best price, and the duty of loyalty to refrain from acting against the wishes of the beneficiaries. The court, while stating that the trustees should have contacted the court for instructions, would not permit the trustees to violate the principals' wishes.³⁷³

47 F.3d 498, 500 (2d Cir. 1995), discussed above, where individuals had dual roles as both company officers, owing a duty to the company, and trustees of a retirement plan, owing duties to the plan participants. Certain employees were excluded from an early retirement incentive program and sued. *Id.* at 501. The court was forced to decide whether the fiduciaries should have upheld their duty to the company, which sought to exclude the employees from the particular plan, or their duty to the employees, who sought to participate in the plan. *Id.* at 504, 507. In deciding the case in favor of the company and not the employees, the court of appeals focused on the lack of harm to the employees. They were denied only increased benefits provided to other employees whose jobs were at greater risk of elimination and otherwise "suffered no reduction in the non-Program benefits to which they were entitled." *Id.* at 507. The court found no harm to the employees, only that they received fewer benefits than they would have received had they participated in the plan. *Id.* The difference between harm, on the one hand, and simply diminished benefits, on the other, is consistent with the difference between a violation of the duty of loyalty and the duty of care. The court found no harm to the employees, only fewer benefits, and it ruled in favor of the company, not the employees. *Id.* Explaining this case as a decision whether to uphold the duty of loyalty or the duty of care provides a sounder basis for the result than relying on the lack of a property interest suggested in the opinion. *Id.*

367. 138 A. 388 (N.J. Ch. 1927).

368. *Id.*

369. *Id.*

370. *Id.*

371. *Id.* at 389.

372. *Id.*

373. *Shanley's Estate* also can be viewed as presenting a dilemma between a duty of loyalty, owed to the principals to refrain from opposing their wishes, and a duty of care, owed to those same persons to ensure their investments were sound. The court pointed out that, while the beneficiaries opposed a sale, the trustee argued that he had a duty to diversify the investments and that the market for the stocks was favorable at the time. *Id.* The trustee expressed concern that he could face liability

3. *The business judgment rule*

Finally, the notion that courts are more concerned about harm inflicted on the principal in violation of the duty of loyalty than about promoting the principal's well-being consistent with the duty of care is reflected through the application of the business judgment rule, which sits at the intersection of the duties of loyalty and care. Courts applying the business judgment rule look first to whether the directors have violated the duty of loyalty. Has there been fraud or self-dealing? If not, courts presume the director has exercised informed business judgment, consistent with his duty of care.³⁷⁴ If, however, a court finds a director violated his duty of loyalty, through self-dealing or other improper actions, the court will find the director liable for a breach of fiduciary duty without further inquiry into the reasonableness of his actions under the duty of care.

This point is now codified in the Delaware General Corporation Law. Section 102(b)(7) provides that a company's certificate of incorporation may contain a provision limiting a director's liability for a breach of fiduciary duty as long as the provision does not limit liability for breach of the duty of loyalty or good faith.³⁷⁵ The business judgment rule does not protect actions taken in bad faith.³⁷⁶ And bad faith is not mere negligence, rather, it implies "the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . a state of mind affirmatively operating with furtive design or ill will."³⁷⁷ Thus, as long as the director has not acted to harm another—a breach of the duty of loyalty—his liability for a breach of the duty of care may be limited.

In each of the three areas examined—attorney-client relations, responsibilities of financial firms, and duties of directors and trustees—a common theme emerges: courts are more concerned with potential harm to a fiduciary's principal than with inadequate

to certain beneficiaries who were then infants if he failed to diversify, and he offered to refrain from selling the shares only if he would be indemnified against loss resulting from such a claim. *Id.* The court, however, was far more concerned that the trustee not act contrary to the wishes of the beneficiaries than that he act to increase incrementally the benefits to the infants. *Id.* The court said, "Our trustee, apparently, is not alarmed over liability for selling the stock against the protest of a large majority of our wards, and without indemnity against personal loss." *Id.*

³⁷⁴. See *supra* notes 199-201 and accompanying text.

³⁷⁵. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

³⁷⁶. *In re Croton River Club, Inc.*, 52 F.3d 41, 45 (2d Cir. 1995); see also *Wash. Bancorp. v. Said*, 812 F. Supp. 1256, 1269 (D.D.C. 1993) (lack of good faith requires an allegation that the decision was motivated by self-interest).

³⁷⁷. *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1208 n.16 (Del. 1993) (quoting BLACK'S LAW DICTIONARY 337 (5th ed. 1983)).

stewardship or other violations of the duty of care. In each case, when faced with a conflict of duty owed to multiple principals, courts preserve the duty of loyalty over the duty of care. The theme is persistent. It presents itself not only in the case law, but also in the Restatement's rules on consenting to attorneys' conflicts, in procedures established by financial firms, and in the business judgment rule for company directors. None of this should come as a surprise. The theme is based on the difference between duties of loyalty and care, which itself is rooted in the difference between Kant's perfect and imperfect duties.

CONCLUSION

While duties of loyalty generally do not conflict with other duties of loyalty, and while conflicting duties of care typically only raise issues of competing resources, the fiduciary's duty of loyalty can conflict with the duty of care leaving her boxed into a corner. Approaches taken by some courts on an *ad hoc* basis cannot be applied easily to others. A closer look at the cases, enriched by a deeper understanding of the nature of the fiduciary duties of loyalty and care, points to a consistent approach. When a fiduciary is faced with a conflict, because acting to benefit one principal would result in harm to another, courts generally hold that the fiduciary should refrain from acting. In such cases, a breach of the duty of care is treated more leniently than a breach of the duty of loyalty. This explains why the duty of confidentiality trumps the duty to provide a more effective defense or provide better investment advice. The principal's first claim is that the fiduciary must refrain from causing harm; a claim to the performance of positive acts is secondary. At its core, the approach is self-evident. "Do no harm" is the clarion call of every fiduciary.