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The Lender as Unconventional Fiduciary

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I. INTRODUCTION

"Take my advice." "Trust me." Such phrases usually do not create legal rights or obligations. Under certain circumstances, however, they can transform an ordinary, arms-length commercial relationship into a fiduciary relationship in which "the punctilio of an honor the most sensitive" displaces the "morals of the marketplace."[1]

What is fiduciary law? The question is deceptively simple. Grounded partly in equity and partly in the common law,[2] fiduciary law supplies a moral (not to say moralistic) dimension to the

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[1] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C.J.).

[2] J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 LAW Q. REV. 51 (1981) [hereinafter Shepherd I]. The term "fiduciary" developed from the Latin *fiduciarius*, for trustee or one in a position of trust. ERNEST VINTER, HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS 1 (3d ed. 1955). Much of the law of fiduciaries developed from equitable doctrines concerning trusts. J.C. SHEPHERD, LAW OF FIDUCIARIES 13-14 (1981) [hereinafter SHEPHERD II]; *see* Clews v. Jamieson, 182 U.S. 461, 479-80 (1901); Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919); JOHN N. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE §§ 151, 958 (Spencer W. Symons, 5th ed. 1941); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 880-81 [hereinafter DeMott I]; L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 69-75; Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 1 (1975). Fiduciary law also derives in part from the common law, in particular the law of agency. SHEPHERD II, *supra*, at 13-16; *see* County of Cook v. Barrett, 344 N.E.2d 540, 545 (Ill. App. Ct. 1975); POMEROY, *supra*, § 959; JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA §§ 308, 315 (1st ed. 1836) (Arno Press reprint 1972). In addition, the law of restitution has influenced the development of fiduciary principles. SHEPHERD II, *supra*, at 17-18; *see* Hamberg v. Barsky, 50 A.2d 345, 346 (Pa. 1947); RESTATEMENT OF RESTITUTION introductory note at 4 (1937); ROBERT GOFF & GARETH JONES, THE LAW OF RESTITUTION 490-93 (2d ed. 1978); Malcolm D. Talbott, *Restitution Remedies in Contract Cases: Finding a Fiduciary or Confidential Relationship to Gain Remedies*, 20 OHIO ST. L.J. 320-23 (1959).

body of law that regulates economic activity.[3] Further analysis is complicated by two factors that characterize judicial analysis of fiduciary cases. First, the rhetoric courts employ in deciding fiduciary cases frequently does not correspond to the realities of fiduciary relationships. Second, courts are reluctant to precisely define either the circumstances under which a fiduciary relationship arises or, once it has arisen, the scope of the resulting duties.[4]

Fiduciary rhetoric declares that within a fiduciary relationship, the fiduciary must act in the best interest of the beneficiary, setting aside all self-interest.[5] In practice, however, most fiduciaries are permitted to exercise some degree of self-interest —

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[3] "[G]enerally speaking, the courts endeavor, where possible without too radical a departure from recognized legal rules, to harmonize the necessities of a competitive industrial system of business with the teachings of morality." M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 691 (Sup. Ct. 1924); *see* DeMott I, *supra* note 2, at 891-92; Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 829-32 (1983); Shepherd I, *supra* note 2, at 56. Professor Clark has pointed out that many judicial opinions applying fiduciary law have something of the flavor of sermons. Robert C. Clark, *Agency Costs versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 75-76 (John W. Pratt & Richard J. Zeckhauser eds., 1985). Indeed, the rhetoric of fiduciary law is strikingly moralistic, often including exhortations to behave in accordance with moral precepts rather than rules of law. *See, e.g.*, Thompson v. Cannon, 274 Cal. Rptr. 608, 611 (Ct. App. 1990) ("trust, confidence, integrity and fidelity . . . are the hallmarks of a fiduciary relationship"); Thomas v. Schmelzer, 796 P.2d 1026, 1032 (Idaho Ct. App. 1990) ("loyalty, integrity and the utmost good faith and fairness") (quoting Stephens v. Stephens, 183 S.W.2d 822, 824 (Ky. 1944)); *Meinhard*, 164 N.E. at 546 ("duty of the finest loyalty," "punctilio of an honor the most sensitive"); *Beatty*, 122 N.E. at 380 ("constructive trust is the formula through which the conscience of equity finds its expression"); *Globe Woolen*, 121 N.E. at 379 (fiduciary principles are a " 'great rule of law' which holds a trustee to the duty of constant and unqualified fidelity") (citation omitted); *see also* Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 539-40 (1949) (using the Parable of the Unjust Steward, Luke 16:1-8, as a text for fiduciary analysis). Not everyone agrees that this is a desirable state of affairs. *See, e.g.*, SHEPHERD II, *supra* note 2, at 57 n.36.

[4] *See* DEBORAH A. DEMOTT, FIDUCIARY OBLIGATION, AGENCY AND PARTNERSHIP 2 (1991) [hereinafter DEMOTT II] (comparing the imprecision of fiduciary law to Dickens' description of London and Chancery in *Bleak House*: "Fog everywhere."). One consequence of this phenomenon of "fiduciary vagueness" is a scarcity of writing about general principles of fiduciary law. Another is that fiduciary law is seldom studied as a coherent whole; rather, it is fragmented into seemingly unrelated parts and studied in various law school courses. *See* Frankel, *supra* note 3, at 796.

[5] *E.g.*, RESTATEMENT (SECOND) OF TRUSTS § 170 (1959) (fiduciary's duty of loyalty); *see* Earl Park State Bank v. Lowmon, 161 N.E. 675, 679 (Ind. Ct. App. 1928); First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970); Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982); P.D. FINN, FIDUCIARY OBLIGATIONS 27, 45 (1977); *see also* Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1676 & n.5 (1990).

when, and how much, vary with the relationship in question.[6] Although agents,[7] corporate directors,[8] officers,[9] shareholders,[10] insurers[11] and other entities[12] are all fiduciaries, they are not gov-

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[6] For example, the rules applicable to fiduciary relationships generally require that the fiduciary disclose the material details of any conflict of interest to the beneficiary. *E.g.*, Davis v. Harrison, 240 F. 97, 100 (9th Cir. 1917); Bank of Ill. v. Bank of Ill., 300 N.E.2d 507, 509 (Ill. App. Ct. 1973); *First Nat'l Bank*, 181 N.W.2d at 182; RESTATEMENT (SECOND) OF AGENCY § 381 (1958) (duty to give information); *see* AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 216 (4th ed. 1988) (consent of beneficiary). With regard to corporate officers and directors, however, the notion of fiduciary duty appears to mean only that the result of a transaction must be "fair" to the corporation, whether or not disclosure was made. *See, e.g.*, CAL. CORP. CODE § 310 (West 1990) (validity of contracts in which a director has a material financial interest); DEL. CODE ANN. TIT. 8, § 144 (1991) (interested directors); N.Y. BUS. CORP. L. § 713 (McKinney 1986) (interested directors); *see* Lewis v. S.L. & E., Inc., 629 F.2d 764, 769 (2d Cir. 1980); *In re* Franklin Nat'l Bank Sec. Litig., 2 B.R. 687, 707 (E.D.N.Y. 1979), *aff'd*, 633 F.2d 203 (2d Cir. 1980); Tevis v. Beigel, 344 P.2d 360, 365 (Cal. Dist. Ct. App. 1959); Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 WL 111134, at *10 (Del. Ch. June 24, 1991) (mem.). In the close corporation context, this dilution has been characterized as an abandonment of fiduciary principles altogether. *See* Mitchell, *supra* note 5, at 1680-82. The most recent trend may be toward requiring disclosure, however. *See* A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §§ 5.01, 5.02 & cmt. a (Proposed Final Draft 1992) (stating that director's and senior executive's duty of fair dealing is fulfilled if disclosure is made and transaction is fair).

[7] RESTATEMENT (SECOND) OF AGENCY § 13 (1957); *see, e.g.*, Caleb & Co. v. E.I. DuPont de Nemours & Co., 599 F. Supp. 1468, 1475 (S.D.N.Y. 1984); Batson v. Strehlow, 441 P.2d 101, 110 (Cal. 1968); Chodur v. Edmonds, 220 Cal. Rptr. 80, 84 (Cal. Ct. App. 1985); State v. Joy, 549 A.2d 1033 (Vt. 1988); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700 (1982).

[8] *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 306 (1939); Professional Hockey Corp. v. World Hockey Ass'n, 191 Cal. Rptr. 773, 776 (Cal. Ct. App. 1983); Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66, 74 (Cal. Ct. App. 1952); Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 WL 111134 (Del. Ch. June 24, 1991); Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 25 (N.Y. 1984); 3 WILLIAM M. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (perm. ed. rev. vol. 1986 & Supp. 1990); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 625 (3d ed. 1983); Easterbrook & Fischel, *supra* note 7, at 700.

[9] *See, e.g.*, Wilshire Oil Co. of Texas v. Riffe, 406 F.2d 1061, 1062 (10th Cir.), *cert. denied*, 396 U.S. 843 (1969); Singer v. Magnavox Co., 380 A.2d 969, 977 (Del. 1977), *overruled on other grounds sub nom.*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[10] *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505 (Mass. 1975); Smith v. Atlantic Properties, Inc., 422 N.E.2d 798 (Mass. Ct. App. 1981).

[11] *See, e.g.*, Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 169 (Cal. 1979), *cert. denied*, 445 U.S. 912 (1980); Gibson v. Government Employees Ins. Co., 208 Cal. Rptr. 511 (Ct. App. 1984) (insurer's duty less than the strict trustee standard); Bowen v. Government Employees Ins. Co., 451 So.2d 1196 (La. Ct. App. 1984); Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 690 P.2d 1022 (N.M. 1984).

erned by the same standards of conduct. Consequently, the use of similar language to refer to differing obligations and standards of conduct makes the underlying concepts of fiduciary law difficult to grasp.

This imprecision in defining the circumstances under which fiduciary relationships and obligations arise is rationalized on various grounds, most commonly that a certain vagueness in fiduciary law is essential to the purposes served by the doctrine. The concern is that if fiduciary law were more clear, it would encourage conduct adhering to the letter of the rule while violating its spirit.[13]

The resulting difficulty in identifying and articulating underlying principles of fiduciary law leads some to conclude that the fiduciary doctrine is incapable of definition,[14] or that there is in fact no coherent fiduciary doctrine at all but merely a series of rules, related only superficially.[15] Others, however, have developed coherent and persuasive theories that are useful in explain-

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[12] *See, e.g.*, United States v. Margiotta, 688 F.2d 108, 122-25 (2d Cir. 1982) (political party officer a fiduciary of the electorate), *cert. denied*, 461 U.S. 913 (1983); *In re* Estate of Thelen, 450 P.2d 123 (Ariz. Ct. App. 1969) (guardian a fiduciary of ward); Adams v. Paine, Webber, Jackson & Curtis, Inc., 686 P.2d 797, 800 (Colo. Ct. App. 1983) (stockbroker a fiduciary of customers); Cahn v. Antioch Univ., 482 A.2d 120, 132 (D.C. 1984) (law school dean a fiduciary of university); County of Cook v. Barrett, 344 N.E.2d 540, 545 (Ill. Ct. App. 1975) (elected official a fiduciary of constituents); Robinson v. Garcia, 804 S.W.2d 238, 253 (Tex. Ct. App. 1991) (attorney a fiduciary of client).

[13] *See infra* notes 40-45 and accompanying text. In a few cases, the fiduciary doctrine has been codified or incorporated into a statute, and occasionally a degree of increased precision has resulted. The corporate opportunity doctrine, for example, has evolved into a fairly coherent set of rules that corporate officers and directors can follow. In most cases, however, the fiduciary obligation remains elusive. For example, the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C.A. §§ 1001-1461 (West 1985 & Supp. 1991) provides no real guidance as to the nature of the fiduciary relationship. Although ERISA preempts state law, 29 U.S.C.A. § 1144(a) (West 1985 & Supp. 1991), its fiduciary standards are based on common-law fiduciary principles, *see* 29 U.S.C.A. § 1104(a)(1) (West 1985 & Supp. 1991) (fiduciary must act solely in the interest of participants and beneficiaries), and courts have referred to the common law of fiduciary duty to interpret the statute. *See, e.g.*, Donovan v. Mercer, 747 F.2d 304 (5th Cir. 1984); Pension Fund - Mid Jersey Trucking Industry - Local 701 v. Omni Funding Group, 731 F.Supp. 161 (D.N.J. 1990). Similarly, federal farm lenders are bound by regulations requiring conduct in accordance with poorly-defined fiduciary standards. *See* 12 C.F.R. §§ 601.100, .110(g) (1991) (officers of production credit association must observe the "highest standards of conduct" in the discharge of their duties). In this way federal law codifies the imprecision of common-law fiduciary principles.

[14] *See, e.g.*, Broomfield v. Kosow, 212 N.E.2d 556, 559-60 (Mass. 1965); *see also* SHEPHERD II, *supra* note 2, at 4, 9.

[15] *See* Finn, *supra* note 5, at 1; DeMott I, *supra* note 2, at 915; Sealy, *supra* note 2, at 73; Talbott, *supra* note 2, at 324.

ing and understanding the fiduciary cases, and in suggesting the direction and manner in which the doctrine should develop in the future.[16]

This Article examines one kind of fiduciary relationship — one that develops from an ordinary, arms-length commercial relationship between a lender and a borrower. Although this prototype relationship exists in the broader context of "lender liability," to which academic commentators and the practicing bar have paid a good deal of attention in recent years,[17] the suggested analysis has as much to do with fiduciary relationships generally as it does with issues of lender liability.

The unconventional fiduciary relationship examined here differs in several respects from the conventional fiduciary relationship, for example that of trustee-beneficiary. Perhaps the most obvious difference is that the parties to an unconventional fiduciary relationship begin their relationship with a different set of goals and expectations than do the parties to a conventional fiduciary relationship. The differences between conventional and unconventional fiduciary relationships have not been evaluated for their impact on the goals of fiduciary law, the process of determining whether a relationship is fiduciary, or whether fiduciary duties have been breached. This Article reveals that the distinction between conventional and unconventional fiduciaries is important in at least two respects. First, imprecision serves no useful purpose in the analysis of unconventional fiduciary cases; in fact, in such cases, imprecision hinders the achievement of the goals of fiduciary law. Second, it is both possible and useful to clarify fiduciary principles as they are applied to unconventional fiduciaries.

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16 *See, e.g.*, SHEPHERD II, *supra* note 2; Frankel, *supra* note 3; Shepherd I, *supra* note 2.

17 *See, e.g.*, GERALD R. BLANCHARD, LENDER LIABILITY LAW, PRACTICE AND PREVENTION (1989 & cum. supp. 1991); Steven C. Bahls, *Termination of Credit for the Farm or Ranch: Theories of Lender Liability*, 48 MONT. L. REV. 213 (1987); Werner F. Ebke & James R. Griffin, *Lender Liability to Debtors: Toward a Conceptual Framework*, 40 S.W. L.J. 775 (1986); Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131 (1989); Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein and the Uniform Commercial Code*, 68 TEX. L. REV. 169 (1989) [hereinafter Patterson I]; Special Project: *Lender Liability*, 42 VAND. L. REV. 853 (1989); Note, *K.M.C. v. Irving Trust Co.: Discretionary Financing and the Implied Duty of Good Faith*, 81 NW. U. L. REV. 539 (1987); Scott L. Baena, *Emerging Theories of Lender Liability*, 61 FLA. BAR J. 55 (Jan. 1987); A. Barry Cappello, *The Lender-Liability Case: Tips for the Borrower's Lawyer*, 23 TRIAL 88 (Nov. 1987); Daniel S. Hinerfeld, *Now It's Lenders Who Must Beware*, 7 CAL. LAW. 61 (Sept. 1987); Debra C. Moss, *Borrowers Fight Back with Lender Liability*, 73 A.B.A. J. 64 (March 1, 1987).

Part II of this Article discusses the nature of fiduciary relationships in general and the purposes served by fiduciary doctrine. Part III distinguishes between conventional and unconventional fiduciaries, situates lenders in the context of unconventional fiduciaries, describes the impact of fiduciary principles on the lender-borrower relationship and discusses the difficulties that arise when fiduciary principles are transplanted from the conventional fiduciary context to that of the unconventional fiduciary. Part IV evaluates critically the factors courts emphasize in determining the existence of a fiduciary relationship, and suggests a method for their application that, consistent with fiduciary theory, emphasizes power and the possibility of its abuse.

II. The Nature of Fiduciary Relationships in General

Fiduciary analysis comprises two fundamental issues: first, whether the relationship is fiducial or not; and second, if it is, whether the resulting fiduciary duties were breached.[18] The former is the threshold question, because fiduciary principles apply only within fiduciary relationships. If it is determined that a relationship is fiducial, then the second issue must be addressed: Were the fiduciary duties created by the relationship breached? This issue may also be framed in terms of scope: What is the scope of the fiduciary duties — that is, of the enforceable rights —created by the relationship?

A. Fiduciary Theory: Duty and Power

Efforts to determine whether a relationship is fiduciary, and the scope of fiduciary duty, should be grounded in theory and not merely in mechanical rules. Although this proposition may seem self-evident, fiduciary law has evolved largely through the mechanical application of rules, without much consideration of their basis.[19] There are three practical considerations that make it desirable to uncover the underlying theory of fiduciary law. First, there is an inherent benefit in a consistent and solid foundation for legal rules; without this, rules risk arbitrariness and irrationality. Second, the need for a coherent theory of fiduciary relationships is becoming more acute as societal emphasis on personal interdependence increases.[20] Finally, as litigants assert

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18 *See* Shepherd I, *supra* note 2, at 35; DeMott I, *supra* note 2, at 882.

19 *See* Shepherd I, *supra* note 2, at 8.

20 Professor Frankel has written of "the rise of the fiduciary society." Frankel, *supra* note 3, at 797-802. She attributes this concept primarily to two trends. First,

fiduciary causes of action and seek fiduciary remedies more frequently, courts need to determine whether fiduciary concepts are appropriate to the cases before them;[21] these decisions will be facilitated by a consistent theory of fiduciary law. As one commentator stated: "[W]ithout any clarification . . . [w]e will continue to stumble around blindly, bumping into new fact situations without really seeing them, and solving them in the dark."[22]

Although so far no single theory of fiduciary duty has won universal acceptance,[23] there is consensus on many fundamental points.[24] In a fiduciary relationship, the fiduciary, whether conventional or unconventional, accepts power[25] to act in a manner that will affect some aspect of the beneficiary's[26] existence. The

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the increasing specialization of function in society that has resulted in "the specialist becoming the substitute for all those in society who seek his expertise." *Id.* at 803. Second, there is increased pooling of resources to be managed by experts, who substitute for the beneficial owners. *Id.* at 803-04; *see also* SHEPHERD II, *supra* note 2, at 35-36.

21 Shepherd I, *supra* note 2, at 51.

22 SHEPHERD II, *supra* note 2, at 9. Notwithstanding the need for a coherent theory of fiduciary law, there has been relatively little scholarship conducted in the field. The number of scholarly books devoted to the subject stands at only four: DEMOTT II, *supra* note 4; Finn, *supra* note 5; SHEPHERD II, *supra* note 2; and VINTER, *supra* note 2. The scarcity of writing on the subject was noted by Professor Frankel in 1983, *see* Frankel, *supra* note 3, at 796 & n.9, and matters have not changed appreciably since then. The recent appearance of some scholarly articles on fiduciary law suggests that the era of neglect may be drawing to a close. *See, e.g.*, DEMOTT II, *supra* note 4; SHEPHERD II, *supra* note 2; DeMott I, *supra* note 2; Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decisionmaking — Some Theoretical Perspectives*, 80 NW. U. L. REV. 1 (1985); Easterbrook & Fischel, *supra* note 7; Mitchell, *supra* note 5; Steve H. Nickles, *The Objectification of Debtor-Creditor Relations*, 74 MINN. L. REV. 371 (1989); Shepherd I, *supra* note 2. In particular, the recent appearance of Professor DeMott's casebook, DEMOTT II, *supra* note 4, holds promise that the sophistication of fiduciary analysis will keep pace with the increasing significance of fiduciary law.

23 A useful summary of the theories underlying judicial decisions and scholarly writing on fiduciary law, including the theory that "there is no theory," appears in SHEPHERD II, *supra* note 2, at 51-91; *see also* DeMott I, *supra* note 2, at 908-15. The theory adopted here draws heavily on that proposed by Shepherd, in particular his concept of the transfer of "encumbered power," *see* SHEPHERD II, *supra* note 2, at 93-123; Shepherd I, *supra* note 2, at 74-79, and on Professor Frankel's view that the primary risk in fiduciary relationships, and the primary problem in need of address, is that the fiduciary will abuse its power. *See* Frankel, *supra* note 3, at 795-97.

24 *See* Mitchell, *supra* note 5, at 1682-85 & n.33.

25 Frankel, *supra* note 3, at 809.

26 The term "beneficiary" is used here, not in the sense in which it is used in the law of trusts, but rather to signify the person that benefits from a fiduciary relationship. The beneficiary is the counterpart of the fiduciary and is the person to whom the fiduciary duty is owed. In a lender fiduciary case, the beneficiary is the borrower.

Other writers have adopted different terminology. Professor Frankel uses the

power transferred, however, is subject to an important limitation: it may be exercised only for the beneficiary's benefit. Such power is referred to in this Article as "fiduciary power." It has been described as "a power to make a choice for or against one's beneficiary,"[27] and it amounts to control over some aspect of the beneficiary's existence.[28] The beneficiary is often, but not always, the transferor of fiduciary power. For example, in the classic trust case, the source of the fiduciary power over the beneficiary is the settlor.

Although fiduciary power involves control over some aspect of the beneficiary's existence, this control is not absolute — it does not imply a helpless beneficiary confronted with an all-powerful fiduciary. How much control the fiduciary has, and over what portion of the beneficiary's existence, varies; the power may be broad or narrow. Fiduciary power is not the equivalent of market power, bargaining power or other kinds of power. It is merely the formal power to affect some aspect of the beneficiary's existence, and as such, may be far less significant than other powers retained by the beneficiary. Shepherd provides the example of "John Smith . . . the trustee of a trust the beneficiary of which is General Motors."[29] Formal power to affect some aspect of GM's existence is in Smith, but this does not permit the conclusion that GM is in any other sense at Smith's mercy.

If fiduciary power is to be useful to society, some balancing mechanism is needed to regulate the exercise of that power and to prevent its abuse. This mechanism is provided by fiduciary law, the essence of which is to impose on the fiduciary a duty of loyalty.[30] The duty of loyalty requires fidelity to the beneficiary's

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term "entrustor" to signify the person to whom a fiduciary obligation is owed. Frankel, *supra* note 3, at 800 & n.17. The term is appealing, but, as Frankel recognizes, also potentially misleading insofar as the power may be entrusted to the fiduciary by someone other than the person to whom the fiduciary obligation is owed. Wolinsky and Econome use the term "reliant," whose counterpart is the "advisor." Sidney M. Wolinsky & Janet Econome, *The Need for a Seller's Fiduciary Duty Toward Children*, 4 HASTINGS CONST. L.Q. 249, 266 (1977).

[27] SHEPHERD II, *supra* note 2, at 98 (footnote omitted).

[28] Fiduciary power may be legal — for example, the power to sign a contract on behalf of a principal—or practical, for example the power to control the actions of another by giving advice that will be followed. *See* Frankel, *supra* note 3, at 827 n.112; Shepherd I, *supra* note 2, at 75.

[29] SHEPHERD II, *supra* note 2, at 62; Shepherd I, *supra* note 2, at 69.

[30] Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 WL 111134, at *15 (Del. Ch. June 24,1991) (mem.); *see* DEMOTT II, *supra* note 4, at 1. Although fiduciaries may have other, more specific duties to their respective beneficiaries, every fiduciary relationship includes the duty of loyalty. *E.g.* RESTATEMENT (SECOND) OF

objectives and well-being, regardless of the consequences to the fiduciary.[31] The abuse of power against which fiduciary law protects is not merely the use of fiduciary power to affirmatively harm the beneficiary, but includes using fiduciary power to benefit the fiduciary rather than the beneficiary.[32]

Fiduciary relationships thus involve a complex sharing of power. The fiduciary controls an aspect of the beneficiary's existence, while fiduciary law gives the beneficiary the ability to regulate, albeit indirectly, the fiduciary's exercise of power.[33] Moreover, the exercise of power by both parties may be limited by statute, contract or other common-law principles. Agency law provides an example: the principal is the beneficiary, the agent the fiduciary. The principal has the power to direct the goal of the agency, and the agreement between the principal and the agent specifies the extent to which the principal may rightfully interfere with or direct the manner in which the goal of the agency is accomplished. The principal submits to the power of the agent to accomplish that goal, and is bound by the agent's success or failure in doing so. The actions of both parties are measured by contract law and agency law; the agent's actions also are tested by fiduciary standards.

One effect of these reciprocal powers is that the ability of the fiduciary to breach its fiduciary duty to the beneficiary is directly proportionate to the freedom given to the fiduciary to exercise the fiduciary power; that is, to the breadth of the power transferred to the fiduciary.[34] Conversely, the more control the bene-

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TRUSTS §§ 169, 171-85 (1959) (delineating duties of trustees in addition to the duty of loyalty noted in *id.* § 170).

[31] For exceptionally stirring rhetoric to this effect, see the language of then Judge Cardozo in Globe Woolen Co. v. Utica Gas & Elec. Co., 121 N.E. 378, 379 (N.Y. 1918), and in Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). The idea is occasionally described as an intolerance for conflict of interest in the fiduciary, but as Shepherd has pointed out, this is not strictly true. *See* SHEPHERD II, *supra* note 2, at 149. Rather, it is the exercise of discretion in a manner favoring the fiduciary that is prohibited. "[T]he legal system pounces on the fiduciary who has *actualized* his conflict of interest, not the fiduciary who is faced with it." SHEPHERD II, *supra* note 2, at 149 (emphasis added).

[32] *See* SHEPHERD II, *supra* note 2, at 147-51.

[33] *See* Frankel, *supra* note 3, at 803, 819; *see also* Finn, *supra* note 5, at 27.

[34] Some writers describe the power separately from the freedom to exercise it. *See, e.g.*, Finn, *supra* note 5, at 27. Conceptually, however, the freedom to exercise the fiduciary power is merely descriptive of the power itself. *See* Shepherd I, *supra* note 2, at 68-69. Similarly, broad powers are sometimes described as the ability to act free of the beneficiary's control. The beneficiary may, however, retain a right to "interfere" with the fiduciary. In the agency relationship, for example, the fiduciary (the agent) has the most immediate control over the accomplishment of the benefi-

ficiary exercises over the fiduciary, the less potential for breach of fiduciary duty exists. Less control by the beneficiary implies a broader power in the fiduciary, and a correspondingly greater potential for breach of fiduciary duty. Similarly, the scope of the fiduciary duty is proportionate to the breadth of the fiduciary's power; sweeping powers connote a broad duty.[35] Consider the servant agent: the principal's control over the agent extends to the means by which the agency's goal is accomplished. A hypothetical servant agent that had no power at all to determine the means by which the goals of the agency were to be accomplished would, while remaining technically a fiduciary of the principal, in fact have no ability to breach its fiduciary duty. Such an agent's actions would be governed completely by the principal.[36] Practically speaking, of course, all agents retain some ability to determine the means by which the agency's goal will be accomplished.

Finally, fiduciary duties do not include the duty of care.[37] Fiduciaries often owe a duty of care to their beneficiaries, which in some, but not all, cases is more demanding than that owed the general public,[38] but not every duty owed by a fiduciary to a beneficiary is a "fiduciary duty." It serves no useful purpose so to expand the idea of fiduciary duty. Although fiduciary status at times may be relevant to assessing the duty of care owed a beneficiary, the duty of care is defined and governed not by fiduciary law but by tort (and sometimes contract) law. Clarity of analysis is enhanced by maintaining this distinction.[39] Tort law is no

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ciary's (the principal's) goal. The principal, however, determines the goal and may, in the case of a servant agent, direct very specifically the manner in which the goal is to be accomplished.

35 *See* Shepherd I, *supra* note 2, at 77.

36 *See* DeMott I, *supra* note 2, at 901; *cf.* Frankel, *supra* note 3, at 812-14 (describing control of the fiduciary as a means to reduce the risk of breach of fiduciary duty).

37 *See* SHEPHERD II, *supra* note 2, at 48-49; DeMott I, *supra* note 2, at 915.

38 *Cf.* RESTATEMENT (SECOND) OF TRUSTS §§ 174, 176, 180, 184 (1959) (setting forth duties of care applicable to trustees in the ongoing administration of the estate).

39 *See, e.g.*, Stone v. Davis, 419 N.E.2d 1094 (Ohio), *cert. denied*, 454 U.S. 1081 (1981), in which the court concluded that a lender owed a borrower a fiduciary duty of disclosure. According to the court, the duty would have been fulfilled had the lender followed its usual policy of advising mortgagors that if they wanted credit life insurance, they would have to obtain it themselves. *Stone*, 419 N.E.2d at 1098. The court characterized the lender's failure to follow its own policy as negligent, and affirmed a judgment for the borrower on that ground. *Id.* at 1099. Finding the existence of a fiduciary relationship, with the concomitant duty to disclose, however, renders irrelevant the reason for the lender's nondisclosure. The primary duty breached is the fiduciary duty to the borrower, not the duty of care. The *Stone* court's analysis blurs this distinction.

more "fiduciary" than is tax law, although most fiduciaries are subject to both.

In sum, fiduciary relationships are based on the power of one person — the fiduciary — to affect some aspect of another's — the beneficiary's — existence. This fiduciary power is transferred to, and accepted by, the fiduciary. Fiduciary power, however, is limited: To say that one person has fiduciary power over another does not mean that the fiduciary has "more" power, in practical terms, than the beneficiary. Fiduciary law gives the beneficiary a means to regulate the fiduciary's exercise of its fiduciary power. A more complete understanding of these principles requires an appreciation of the goals of fiduciary law.

B. The Goals of Fiduciary Law

Fiduciary law serves two primary purposes: it deters the abuse of fiduciary power and provides a means for reviewing the terms of contracts between the fiduciary and the beneficiary for substantive fairness. Both of these aim ultimately at fairness in the relations between fiduciary and beneficiary.

Fiduciaries tend to act conservatively. This tendency is a result of the vagueness of fiduciary law because a person subject to a duty so undefined hesitates to take any action that might, in the hindsight of a court, be deemed a breach. This effect is intentional. The doctrine is designed to deter conduct that borders on a breach.[40] It is thought better that the fiduciary should err on the side of caution.

Economic analysis of fiduciary law also emphasizes the deterrent purpose of fiduciary doctrine. From an economic perspective, fiduciary principles are an alternative to direct monitoring of fiduciaries by beneficiaries.[41] Because the interests of fiduciaries and beneficiaries often diverge, beneficiaries need to ensure that fiduciaries remain faithful to the beneficiary's purpose. One option for beneficiaries is direct monitoring of the fiduciary. This is both expensive and inefficient, however, and in the case of a beneficiary with several fiduciaries, would quickly become unwieldy. Fiduciary law makes such direct supervision unnecessary, replacing it with deterrence achieved by the threat of a penalty[42] to be

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[40] *See infra* note 93 and accompanying text.

[41] Easterbrook & Fischel, *supra* note 7, at 700-03; *see also* Alison G. Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. REV. 738, 759-61 (1978); Frankel, *supra* note 3, at 803-04.

[42] One factor impeding realization of fiduciary law's deterrent purpose is that a

paid by a faithless fiduciary. This deterrence is achieved at less cost than direct monitoring, and does not require additional resources from the beneficiary as the number of fiduciaries increases. Fiduciary law is therefore more efficient than direct monitoring.

One purpose of fiduciary law, then, is to deter conflicts of interest in fiduciaries, or at least to provide an incentive for fiduciaries to remain faithful in the face of temptation to indulge their self-interest. This purpose is aided by the reluctance of courts to delimit the circumstances under which the fiduciary duty may be breached.

A second, and less frequently articulated, purpose of fiduciary law is to provide a means for reviewing the terms of contracts arising within the scope of a fiduciary relationship. Fiduciary law reflects a belief that transactions between the parties to such an intimate relationship are fraught with the risk of overreaching and abuse of power and, therefore, ought not to remain subject to ordinary contract standards. Thus, transactions between a fiduciary and beneficiary are subject to review for substantive fairness.[43] This review begins with presumptions of unfairness and

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breach of fiduciary duty sounds in equity, and frequently only equitable remedies are available to the beneficiary. *E.g.*, Dietz v. Dietz, 70 N.W.2d 281, 285 (Minn. 1955) (constructive trust); Sinclair v. Purdy, 139 N.E. 255, 258 (N.Y. 1923) (unjust enrichment). Particularly when the beneficiary has not suffered an out-of-pocket loss, the risk of breaching the duty may not suffice to prevent a violation of the duty of loyalty, since often the only penalty is forfeiture of the ill-gotten gains. Shepherd concludes that deterrence is not properly a purpose of fiduciary law. SHEPHERD II, *supra* note 2, at 82 n.122. It is submitted that rethinking the doctrine and the remedies is a better approach. Punitive damages are, in fact, increasingly awarded in fiduciary cases. *See, e.g.*, Security Pac. Nat'l Bank v. Williams, 262 Cal. Rptr. 260, *review denied, opinion withdrawn from publication*, 1989 Lexis 2309 (Cal. 1989); Callis v. Mellon Bank, No. 89-696 (Colo. Dist. Ct. Douglas County, April 30, 1991). Other courts have held that punitive damages are appropriate in cases that, although nominally pleaded as torts, appear to raise predominantly fiduciary questions. *E.g.*, Jacques v. First Nat'l Bank, 515 A.2d 756, 758-63 (Md. 1986); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 620 (Okla. Ct. App. 1982). It could be argued that punitive damages should be available routinely in fiduciary cases, but such a concern is beyond the scope of this Article.

[43] Nickles, *supra* note 22, at 375. This normative interpretation of agreements may occur in other contexts as well. Professor Patterson has argued that normative application of communitarian values by lay juries can explain "good faith" lender liability cases arising from acceleration and refusal to lend. DENNIS M. PATTERSON, GOOD FAITH AND LENDER LIABILITY, ch. 6 & 153-54 (1989) [hereinafter PATTERSON II]; Patterson I, *supra* note 17, at 208-11. According to Patterson, "the [Uniform Commercial] Code inexorably establishes that community members — not participants in commercial practices — are the arbiters of normative, communal conflict." Patterson I, *supra* note 17, at 209. In Patterson's view, the principal architect of the Code, Karl Llewellyn, understood that the concepts of "good faith" and "agree-

undue influence, placing the burden on the fiduciary to demonstrate the agreement's enforceability.[44]

In sum, the ambiguity of fiduciary law aims at deterrence, and the interpretive aspect of fiduciary doctrine seeks to impose communitarian notions of fairness on contracts between fiduciary and beneficiary.[45] Achieving these goals is the primary purpose of fiduciary doctrine. In particular, the ambiguity of fiduciary law is legitimate only insofar as it serves its deterrent purpose.

III. CONVENTIONAL AND UNCONVENTIONAL FIDUCIARY RELATIONSHIPS

With the theory of fiduciary relationships as background, Part III of this Article distinguishes between conventional and unconventional fiduciary relationships, examines the place of lenders within this structure and re-evaluates the methods used to accomplish the goals of fiduciary law in light of the differences between conventional and unconventional fiduciaries.

A. Classifying Fiduciary Relationships

There are two categories of fiduciary relationships.[46] The first includes fiduciaries such as trustees, agents, corporate directors and others who enter into relationships that the law classifies

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ment" have a meaning only insofar as they have a context in commercial practice. *Id.* at 204-05. The factfinders in litigation over these and similar concepts necessarily carry on a normative function in interpreting these concepts. Hence society in a sense gets only its just desserts when it is faced with inconsistent, and occasionally irrational, jury verdicts in commercial cases; that is the price to be paid for rejecting Llewellyn's vision of the expert "merchant jury." *See id.* at 207-09.

[44] *See* SHEPHERD II, *supra* note 2, at 209; Vinter, *supra* note 2, at 2.

[45] This appears at first blush to conflict with the requirement that the fiduciary act solely in the interest of the beneficiary. Because the interpretation is inevitably in the beneficiary's favor, however, the conflict is more apparent than real.

[46] Hunt v. Bankers Trust Co., 689 F. Supp. 666, 675 (N.D. Tex. 1987); Atlantic Nat'l Bank of Florida v. Vest, 480 So. 2d 1328, 1332 (Fla. Dist. Ct. App. 1985); Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982); Production Credit Ass'n v. Croft, 423 N.W.2d 544, 546 (Wis. 1988). There are, of course, numerous possible bases for a taxonomy of fiduciary relationships. Shepherd bases his on the nature of the duty to be performed by a fiduciary. Thus, he finds classifications including (i) property-holders, including trustees and receivers; (ii) representatives, including public officials and corporate directors; (iii) advisors, including attorneys, physicians, religious advisors and legal guardians; and (iv) "others," including majority shareholders, franchisors and persons bargaining to become partners. *See* SHEPHERD II, *supra* note 2, ch. 2. Finn bases his analysis on the principle that fiduciary obligations exist only in the context of unique fiduciary relationships. Accordingly, Finn's fiduciary obligation model consists of discrete duties and rules, applicable only in their specific context. *See* Finn, *supra* note 5, at 8-10.

as fiduciary, and who are usually aware, at least in a general way, of their legal status. As a rule, the fiduciary and the beneficiary in this kind of relationship understand that the relationship is not arms-length — although they may not understand the precise nature of the duties and rights that inhere in their relationship. Such relationships are referred to in this Article as "conventional" fiduciary relationships.

The second category includes relationships that begin as ordinary commercial relationships, but become fiduciary because of their particular circumstances. The "fiduciaries" in such cases may be lenders or other persons in commercial relationships.[47] These relationships are referred to in this Article as "unconventional" fiduciary relationships.

The distinction between conventional and unconventional fiduciaries has not gone unnoticed,[48] but, surprisingly, no nomenclature has developed to describe it conveniently. More importantly, no effort has been made to assess systematically the significance of the distinction as it affects the means by which fiduciary law accomplishes its goals. The remainder of this Article explores the unconventional fiduciary relationship, using the relationship between lender and borrower as an illustration.

B. Fiduciary Theory Applied to Lenders

Ordinarily, the lender-borrower relationship is not fiducial, but rather is a creditor-debtor relationship, in which the parties deal at arm's length and neither owes any special duty to the other.[49] A minority of courts apply this rule rigidly, holding that

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[47] *See* Consolidated Oil & Gas, Inc. v. Ryan, 250 F. Supp. 600 (W.D. Ark.), *aff'd per curiam*, 368 F.2d 177 (8th Cir. 1966) (vendor and purchaser); Oil & Gas Ventures - First 1958 Fund, Ltd. v. Kung, 250 F. Supp. 744 (S.D.N.Y. 1966) (party doing business with partnership); Milford Packing Co. v. Isaacs, 90 A.2d 796 (Del. 1952) (warehouseman and depositor); Field v. Oberwortmann, 144 N.E.2d 637 (Ill. App. Ct. 1957) (businessmen); J.R.F. Lehane, *Fiduciaries in a Commercial Context*, *in* ESSAYS IN EQUITY (P.D. Finn ed. 1985).

[48] *See, e.g.*, *Ryan*, 250 F. Supp. at 604-07; Atlantic Nat'l Bank of Florida v. Vest, 480 So. 2d 1328, 1332-33 (Fla. Dist. Ct. App. 1985); *Denison State Bank*, 640 P.2d at 1236-37.

[49] Bank of Red Bay v. King, 482 So. 2d 274, 285 (Ala. 1985); Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 23 (Colo. Ct. App. 1981); Hooper v. Barnett Bank, 474 So. 2d 1253, 1257 (Fla. Dist Ct. App. 1985); Bank Computer Network Corp. v. Continental Ill. Nat'l Bank & Trust Co., 442 N.E.2d 586, 594 (Ill. App. Ct.1982); Kurth v. Van Horn, 380 N.W.2d 693, 698 (Iowa 1986); First Bank v. Moden, 681 P.2d 11, 13 (Kan. 1984); Pigg v. Robertson, 549 S.W.2d 597, 600 (Mo. Ct. App. 1977); Deist v. Wachholz, 678 P.2d 188, 193 (Mont. 1984); Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989); Tokarz v. Frontier Fed. Sav. & Loan Ass'n, 656 P.2d 1089, 1092 (Wash. Ct. App. 1983); Annotation, *Existence of Fiduciary*

a lender is never a fiduciary of its borrower.[50] At the other extreme, some cases have imposed a strict fiduciary duty, akin to that of a trustee, upon a lender.[51] Most courts confronted with the issue have taken a middle road, recognizing a lender's fiduciary duty to a borrower under certain circumstances.[52] This section applies fiduciary theory to the unconventional fiduciary relationship that may arise between a lender and a borrower.

1. The Creditor-Debtor Relationship Transformed

Before the turn of the century, borrowers, by and large, were

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Relationship Between Bank and Depositor or Customer so as to Impose Special Duty of Disclosure upon Bank, 70 A.L.R.3d 1344, 1347 (1976). The same rule applies to the bank-depositor relationship except that the roles are reversed: the depositor is the creditor, while the bank is the debtor. Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937); *see Kurth*, 380 N.W.2d at 696 (rejecting claim that change from depositor to borrower status results in fiduciary relation).

[50] *E.g.*, Delta Diversified, Inc. v. Citizens & S. Nat'l Bank, 320 S.E.2d 767, 776 (Ga. Ct. App. 1984); Centerre Bank v. Distributors, Inc., 705 S.W.2d 42, 53 (Mo. Ct. App. 1985); *cf.* Production Credit Ass'n v. Ista, 451 N.W.2d 118, 121 (N.D. 1990).

[51] *See, e.g.*, Deist v. Wachholz, 678 P.2d at 193 (Mont. 1984); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 619 (Okla. Ct. App. 1982). In *Deist*, the plaintiff, a long-standing customer of the defendant bank, requested the bank's help in selling the plaintiff's ranch upon her husband's death. A sale was arranged to a group of investors, including a vice-president of the bank. When the plaintiff discovered that a certain local physician was also a member of the buying group, she sued for rescission of the sale contract claiming, among other things, a breach of fiduciary duty. The court found that the president of the bank owed the plaintiff a fiduciary duty, and that this duty could be breached derivatively by another officer of the bank. *Deist*, 678 P.2d at 194. Ultimately, the court held that rescission of the sale contract was appropriate, even though there had been no showing of (or, as far as the opinion reveals, any argument concerning) the materiality of the misrepresentation. *See id.* at 198. The plaintiff knew and accepted all of the other contract terms. Thus, the plaintiff was permitted to avoid a transaction based upon the failure to disclose the identity of one of the purchasers, without any evidence bearing upon such non-disclosure's significance. Although this result would not be out of place in a trust case, where it is presumed that a fact to which the plaintiff attaches any significance (even with hindsight born of litigation) is material, it is unusual in a lender case. *See Bank of Red Bay*, 482 So. 2d at 285 (showing of materiality essential to claim based on non-disclosure in a confidential relationship); First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970) (materiality "unavoidably involved" in allegations of non-disclosure). Finally, it is worth noting that in *Deist* the bank itself was never shown to have a fiduciary duty to the plaintiff, much less to have breached one. *See Deist*, 678 P.2d at 194.

[52] Reid v. Key Bank, 821 F.2d 9, 14-15 (1st Cir. 1987). Federal farm lenders, in fact, are required to comply with regulations that impose fiduciary duties. *See* 12 C.F.R. §§ 601.100, .110(g) (1991) (stating that officers of a production credit association must observe the highest standards of conduct in the discharge of their duties and must conduct themselves in the highest manner at all times). These regulations, however, have been held not to provide a private right of action. Hartman v. Farmers Prod. Credit Ass'n, 628 F. Supp. 218, 220 (S.D. Ind. 1983).

unlikely to place their trust in lenders,[53] except perhaps in hoping that cash on deposit would not be embezzled.[54] By 1937, however, the Arizona Supreme Court in *Stewart v. Phoenix National Bank*[55] observed that it had "become a common, if not a universal, practice, for lenders to advertise that they are desirous of performing many services always held to be confidential in their nature."[56]

No longer merely providers of financing, commercial lenders often play a role that includes providing business and financial advice to borrowers.[57] In some cases, lenders are the source of most of the financial acumen necessary for the success of an enterprise. In other cases, borrowers disclose sensitive financial or business information to a lender, with the expectation that it will remain confidential.

The lender-borrower relationship thus comprehends a tension between an intimate role as financial advisor and confidant, and an arms-length role as hard-bargaining creditor.[58] If the lender overemphasizes the intimate role, a fiduciary relationship may result. The likelihood that this will happen is especially

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[53] *See* Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937). This point of view is neatly summed up in a quotation sometimes attributed to Mark Twain: "A banker is a fellow who lends his umbrella when the sun is shining and wants it back the minute it starts to rain." THE CONCISE DICTIONARY OF QUOTATIONS (Robert Andrews ed. 1989); A DICTIONARY OF WIT, WISDOM AND SATIRE (Herbert V. Prochnow & Herbert V. Prochnow, Jr. eds. 1966). Other sources list the origin of the quotation as anonymous. *E.g.*, PENGUIN DICTIONARY OF MODERN HUMOROUS QUOTATIONS (Fred Metcalf ed. 1988); THE BEST QUOTATIONS FOR ALL OCCASIONS (Lewis C. Henry ed. 1945).

[54] When funds on deposit were embezzled, the remedy generally was based upon breach of the duty of care, rather than breach of fiduciary duty. *E.g.*, Bates v. Dresser, 251 U.S. 524 (1920) (Holmes, J.).

[55] 64 P.2d 101 (Ariz. 1937).

[56] *Id.* at 106.

[57] *See id.*; Tokarz v. Frontier Fed. Sav. & Loan Ass'n, 656 P.2d 1089, 1092 (Wash. Ct. App. 1983). The evolution and prevalence of the practice of lenders advising borrowers has resulted in a competitive climate in which it would be risky, at best, for a lender *not* to provide such advice. Borrowers demand the additional services that a professional lender provides; offering business advice and sharing business insight is necessary to compete effectively as a lender. In addition, obtaining such information is often necessary if the borrower is to compete effectively in its market. This in turn benefits the lender, because a successful borrower is more likely to repay its loan on time.

[58] This tension is most pronounced in the case of bank lenders and others whose primary business is lending, and who compete fiercely for borrowers. These lenders seek to compete in more ways than merely price. In-depth knowledge of various industries and the expertise necessary to advise borrowers and to understand the particular difficulties experienced by borrowers in those industries are important differentiating factors in the competition for customers.

acute when repayment of the loan is jeopardized, but it can happen at any time.

2. Existence of an Unconventional Fiduciary Relationship

Although it is possible for a lender-borrower relationship to become fiducial through a formal transfer of power from the borrower to the lender, for example, by an express provision in the contract between the parties, this would be highly unusual.[59] More commonly, the fiduciary status of a lender (in fact, of all unconventional fiduciaries) results from an informal transfer of fiduciary power, in one of two ways: either the lender gives financial or business advice to the borrower,[60] or the lender becomes privy to the borrower's confidential information.[61]

The cases involving advice-giving fit easily into fiduciary theory.[62] When the borrower willingly seeks out and accepts the lender's advice, the borrower voluntarily transfers power to the lender. When the lender forces its advice on the borrower, for example, by threatening adverse action under the credit agreement governing the creditor-debtor relationship, the borrower's transfer of power to the lender is involuntary. In either case, the lender has accepted fiduciary power in the form of control over some aspect of the borrower's existence. The basis for a fiduciary relationship is then in place.

It is less obvious that basing a fiduciary relationship on the

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59 Few, if any, lenders would agree to such a relationship. *See* SHEPHERD II, *supra* note 2, at 229-30.

60 *See* Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937); Barrett v. Bank of Am., 229 Cal. Rptr. 16, 20-21 (Cal. Ct. App. 1986); Atlantic Nat'l Bank v. Vest, 480 So.2d 1328, 1332-33 (Fla. Dist. Ct. App. 1985); Hooper v. Barnett Bank, 474 So. 2d 1253 (Fla. Dist. Ct. App. 1985); Bank Computer Network Corp. v. Continental Ill. Nat'l Bank & Trust Co., 442 N.E.2d 586, 594 (Ill. App. Ct. 1982); Earl Park State Bank v. Lowmon, 161 N.E. 675, 679 (Ind. Ct. App. 1928); Kurth v. Van Horn, 380 N.W.2d 693, 698 (Iowa 1986); Smith v. Saginaw Sav. & Loan Ass'n, 288 N.W.2d 613, 618 (Mich. Ct. App. 1979); Union State Bank v. Woell, 434 N.W.2d 712, 719 (N.D. 1989). Shepherd identifies "advisers" as one category of fiduciary. SHEPHERD II, *supra* note 2, at 28.

61 *See Barrett*, 229 Cal. Rptr. at 20; Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 22 (Colo. Ct. App. 1981); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 617 (Okla. Ct. App. 1982).

62 Professor DeMott has pointed out that it can be difficult to perceive exactly what power has been transferred to an advisor by the beneficiary. *See* DeMott I, *supra* note 2, at 912. When the advice is followed, however, the power becomes clear. For example, a client may entrust himself to a lawyer; the lawyer has little doubt, in most cases, that the advice she gives will be followed. Thus, an advisor's power derives in part from the advice given and in part from the trust reposed in it by the advised.

disclosure of confidential information squares with fiduciary theory. Lender cases usually involve the misappropriation of business opportunities disclosed by the borrower.[63] Although in the United States individuals often consider financial information to be intensely personal,[64] and businesses normally try to maintain the confidentiality of their plans and other proprietary information, the borrower's disclosure of such private or confidential information does not implicate as clearly the transfer of power that is involved in the "giving advice" cases.[65]

Sharing confidential information with the lender does, however, create in the lender the power to harm the borrower — or to benefit the fiduciary — by inappropriate use, including further disclosure or theft of the information.[66] The *power to use* the information is transferred simultaneously with the information itself. This power to use the information, either to harm the beneficiary, to benefit the fiduciary, or both, raises conceptually the same dangers posed in the "giving advice" cases (and, for that matter, in conventional fiduciary cases). That is, the primary danger posed by the disclosure of confidential information is abuse of the power transferred to the lender simultaneously with the disclosure. While the *right* to use the information may not be transferred, it is the transfer of the *power* to do so that causes the fiduciary relationship to arise.

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[63] *See, e.g.*, Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21 (Colo. Ct. App. 1981); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616 (Okla. Ct. App. 1982). Not all cases follow this pattern, however. One abuse of confidential information case involved a lender's delay when, based upon information disclosed by the would-be borrower, the lender should have been aware that the borrower would suffer severe consequences in the event of such a delay. Jacques v. First Nat'l Bank, 515 A.2d 756 (Md. 1986). *Jacques* is interesting in two ways. First, it is unclear that any confidential information actually was abused, at least in any conventional manner. Second, although the case was framed and decided as a tort case, the court spoke of the "tort duty" breached in terms suggestive of fiduciary duty. *See id.* at 762-63.

[64] *Cf. Djowharzadeh*, 646 P.2d at 619 (stating that private information includes financial information such as assets, credit history and future plans).

[65] Shepherd argues that doctrines governing confidential information are not truly fiduciary and prefers to apply fiduciary principles to such cases by analogy. *See* SHEPHERD II, *supra* note 2, at 334-35. His reasoning appears to be that the disclosure of confidential information resembles the transfer of encumbered information, rather than encumbered power. *See id.* at 319-38.

[66] Applying Shepherd's terminology, simultaneously with the transfer of information the beneficiary transfers to the fiduciary the power to use the information — but this power is "encumbered" by the obligation to use it only in the beneficiary's interest. *Cf.* SHEPHERD II, *supra* note 2, at 93-119.

3. "Special" and "Confidential" Relationships

Although applying fiduciary law to lenders is consistent with fiduciary theory, in practical terms it seems incongruous to state that a lender is the borrower's fiduciary. How can a lender, armed with acceleration clauses and rights to foreclose and repossess also be an intimate of the borrower, required to place the borrower's interests above its own? The tension between these two roles is not reconcilable in any meaningful sense; one or the other must prevail.[67] Faced with this dilemma, many courts repond by reaching a fiduciary result without invoking, at least expressly, fiduciary law. Such a result is accomplished by adopting one or the other of the fiduciary stand-ins nondescriptively called "special relationship" and "confidential relationship."[68]

This oblique means of dealing with the cognitive dissonance produced by calling a lender a "fiduciary" has resulted in a good deal of confusion about the nature of the special and confidential relationships.[69] Some courts have held that special or confidential relationships are, in substance, fiduciary relationships,[70] while others painstakingly, if somewhat artificially, distinguish the two.[71] Short of rhetoric and hypertechnicality, it is clear that

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[67] Similar difficulties arise in cases in which the fiduciaries are also beneficiaries; for example, persons who are both shareholders and directors in close corporations. *See* Finn, *supra* note 5, at 42-43.

[68] The "confidential relationship" usually has nothing to do with confidential information. The name may derive from the "confidence" placed by the plaintiff in the ostensible fiduciary. Like the "special relationship," from which it is indistinguishable, the confidential relationship is a vehicle to reach a fiduciary result.

[69] The search for non-fiduciary relationships with fiduciary consequences has produced some bizarre results. Thus, in High v. McLean Fin. Corp., 659 F. Supp. 1561 (D.D.C. 1987), *aff'd sub nom.*, Hill v. Equitable Trust Co., 851 F.2d 691 (3d Cir. 1988), *cert. denied* 488 U.S. 1008 (1989), the court identified a so-called "special confidential relationship." The hallmark of this relationship, according to the *High* court, is that each party is required to act with the best interest of the *other* party uppermost in its mind. *Id.* at 1568. The rule evokes an "After you, my dear Alphonse" scenario, with neither party protecting its own interest, instead diligently protecting that of the other.

[70] Bank of Red Bay v. King, 482 So. 2d 274, 284 (Ala. 1985) (determining that a confidential relationship involves acting for the interests of another); Barrett v. Bank of Am., 229 Cal. Rptr. 16, 20 (Cal. Ct. App. 1986); First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970) (asserting that when the relationship is one of "trust and confidence," the lender is under a duty to act "solely for the [borrower's] interests"). Interestingly, albeit puzzlingly, the same court that decided *Brown* later distinguished it as a case "based on fraud" rather than a case involving fiduciary duty. *See* Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986).

[71] Dale v. Jennings, 107 So. 175, 179 (Fla. 1925) (confidential relation exists when there is no fiduciary relationship and the "transaction is not in its essential nature fiduciary"); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 619 (Okla. Ct. App. 1982) (special duty is not fiducial "because it is . . . arm's length");

the cases invoking a special or confidential duty are in fact applying fiduciary principles.[72] As used in this Article, the term "fiduciary relationship" includes "special" and "confidential" relationships.

4. Fiduciary Theory and the Scope of the Lender's Fiduciary Duty

To this point, the analysis has focused on fiduciary theory as it applies to the question whether the lender-borrower relationship has become fiduciary. If we conclude that the relationship is fiduciary, we then must address the next question: What conduct by the fiduciary will breach its duty of loyalty?

Although unconventional fiduciary cases raise difficult questions as to both issues, questions relating to the first issue, that is, whether the relationship was fiducial, generally predominate. It is unusual for a lender-borrower relationship to become fiducial. When such a claim is made,[73] the parties and court direct most of their energies toward establishing the nature of the relationship. Although examination of the scope of fiduciary duty in the lender-borrower cases tends to be cursory, the duty resulting should not be overlooked. The fiduciary obligations of lenders are of two kinds:[74] a duty to disclose, and a duty not to misuse

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see DEMOTT II, *supra* note 4, at 12 ("confidential relationship" signifies "actual reliance" on the fiduciary); Frankel, *supra* note 3, at 825 n.100 (same). The United States Court of Appeals for the First Circuit has interpreted Maine law even more technically, distinguishing between a "relation," which has legal significance, and a "relationship," which is purportedly a factual situation that may or may not rise to the level of a "relation." Reid v. Key Bank, 821 F.2d 9, 16 n.4 (1st Cir. 1987).

[72] *See* SHEPHERD II, supra note 2, at 161-62; *id.* at 324 ("[W]e have yet to see anyone, judge or academic, effectively distinguish between a confidential relationship and a fiduciary relationship.") (footnote omitted); *cf.* Finn, *supra* note 5, at 263-64 (stating that it is difficult to see how law of "special relationships" differs from fiduciary law).

[73] The incentive to argue that a commercial relationship became fiduciary comes from several sources, perhaps the most notable is the availability of remedies. *See* SHEPHERD II, *supra* note 2, at 9; DeMott I, *supra* note 2, at 888; Shepherd I, *supra* note 2, at 55. Some fiduciary remedies are restitutionary, and therefore do not require the plaintiff to prove any loss. These are increasingly sought by litigants. *See* Talbott, *supra* note 2, at 323. Other incentives to claim a breach of fiduciary duty are provided by avoidance of limitations periods and, simply, the avoidance of contractual obligations that have become onerous.

[74] A possible third fiduciary obligation of a lender originated in California, and involves the "tort of breach of contract": if a fiduciary relationship is found, then a breach of the contractual covenant of good faith and fair dealing, which ordinarily would result only in contractual liability, may be compensable as a tort. *See* Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985). *Commercial Cotton* involved a bank-depositor relationship, which the court

confidential information.

a. *The Duty to Disclose*

The duty to disclose originates in the presumption of undue influence,[75] and exists in both conventional and unconventional fiduciary relationships. In a transaction between a fiduciary and beneficiary, fiduciary law presumes that the fiduciary gained a benefit through abuse of its influence. The presumption may be rebutted by evidence that the beneficiary consented independently and on the basis of full information, and it is in this respect that disclosure becomes significant. Although full disclosure tends to establish that the beneficiary's consent to the transaction was informed, disclosure alone cannot establish the independence of the consent.[76]

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analogized to the insurer-insured relationship. *Id.* at 554. The California courts also recognize a five-part test for determining whether a "special relationship" exists so as to justify the award of tort damages for breach of the covenant of good faith. Wallis v. Superior Court, 207 Cal. Rptr. 123, 129 (Cal. Ct. App. 1984). Both *Commercial Cotton* and *Wallis* derived in part from dictum in an earlier case, Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 686 P.2d 1158 (Cal. 1984), which suggested that such tort damages might be available in any case in which the relationship between the parties is sufficiently similar to that of insurer-insured. *Id.* at 1172. Montana has adopted a rule similar in some respects to that advanced in *Commercial Cotton*. *See* First Nat'l Bank v. Twombly, 689 P.2d 1226, 1230 (Mont. 1984) (maintaining that when duty to exercise good faith is "imposed by law," breach is tortious). Oklahoma has squarely rejected the rule. *See* Rodgers v. Tecumseh Bank, 756 P.2d 1223, 1227 (Okla. 1988) (distinguishing commercial lending agreement from insurance contract; no action for "tortious breach of contract" available in lending cases).

The continued force of *Commercial Cotton* in California is in some doubt since the California Supreme Court decision in Foley v. Interactive Data Corp., 765 P.2d 373 (Cal. Ct. App. 1988). Although *Foley* did not address *Wallis* or *Commercial Cotton* directly, it overturned a line of cases extending tort recovery for breach of the duty of good faith to employment situations, and its analysis suggests a reluctance to tolerate further encroachment of tort remedies on contract terrain. *Foley*, 765 P.2d at 389-90, 399-401. For an interesting discussion of *Foley* and its relationship to *Seaman's* and *Commercial Cotton*, see Price v. Wells Fargo Bank, 261 Cal. Rptr. 735, 738-41 (Cal. Ct. App. 1989).

75 *See* SHEPHERD II, *supra* note 2, at 202-04, 209. This presumption actually comprises two related notions — first, that a fiduciary *has* influence over the beneficiary, and second, that the influence was misused to gain an advantage in the transaction for the fiduciary. *See id.* at 210.

76 "Consent" in the fiduciary context possesses a dual significance. First, when the beneficiary is a party to the transaction, the *personal* consent of the beneficiary is needed. That is, the beneficiary's consent "as an independent actor to a transaction to which he is a party" is indispensable. SHEPHERD II, *supra* note 2, at 199. Second, the beneficiary's *permissive* consent is required. This can be thought of as consent to a temporary redefinition of the scope of the fiduciary's duty, so as to permit the transaction to proceed. *See id.* at 199.

Breach of the duty to disclose can have a variety of legal consequences, among them unenforceability of a contract between the parties, which, in the case of a lender fiduciary, means unenforceability of the credit agreement with the borrower. Thus, in *First National Bank v. Brown*,[77] the borrower avoided repayment of a loan taken to finance a purchase, on the ground that the lender did not disclose independently its preexisting and duly recorded mortgage on the purchased property to the buyer.[78] Similarly, in *Deist v. Wachholz*,[79] a seller of land obtained rescission of the sale contract on the ground that the identity of one of the purchasers was not disclosed to her by the mortgagee of the property, who had advised her in the sale.

Breach of the duty to disclose can also result in liability for fraud. For example, in *Camp v. First Federal Savings & Loan*,[80] the Arkansas Court of Appeals permitted a purchaser of real property to present a jury with a claim that a mortgage lender defrauded her by not disclosing that the property in question was located in an area prone to flooding. In *Rutherford v. Rideout Bank*,[81] the California Supreme Court sustained a damage award to a seller of real property based on a breach of fiduciary duty by a bank officer who both advised the seller and accepted a bribe from the purchaser. In *Security Pacific National Bank v. Williams*,[82] a car dealer (allegedly at one time the nation's youngest holder of a General Motors franchise) who apparently had immense sales talent, but little financial sophistication, won an award of almost $5 million in compensatory and punitive damages in a fiduciary case after following a lender's advice to purchase an ailing dealership to which the lender had substantial exposure. Most dramatically, in March 1991, a real estate developer won a $65 million award in a fiduciary duty case; $23.6 million represented punitive

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77 181 N.W.2d 178 (Iowa 1970).

78 The court that decided *Brown* later distinguished the case as one "based on fraud" rather than breach of fiduciary duty. Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986). As the court noted in *Brown*, however, the "fraud" of the lender was actionable only because of the relationship of trust and because the lender "purported to act solely for the [borrower's] interests." *Brown*, 181 N.W.2d at 182. In this respect *Brown* is indistinguishable from a case based on breach of fiduciary duty.

79 678 P.2d 188 (Mont. 1984).

80 671 S.W.2d 213 (Ark. Ct. App. 1984).

81 80 P.2d 978 (Cal. 1938).

82 262 Cal. Rptr. 260 (Cal. Ct. App. 1989), *review denied, opinion withdrawn from publication*, 1989 Lexis 2309 (Cal. 1989).

damages.[83]

b. *Misuse of Confidential Information*

The duty not to misuse the borrower's confidential information is most often breached when the lender uses the information to compete with the borrower. These cases frequently involve egregious facts; typically a lender takes for itself a business opportunity learned from a customer's loan application.[84] In addition, a lender's fiduciary duty is violated when the confidentiality of borrower information is breached.[85]

The duty not to misuse confidential information, like the duty to disclose, exists in all fiduciary relationships, whether conventional or unconventional. It may be breached even when the beneficiary has not been harmed, if the fiduciary has made a profit. The beneficiary is entitled to recover the fiduciary's profit on the grounds that the power to use the information was conditioned upon its use only for the beneficiary's benefit.[86]

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[83] Callis v. Mellon Bank, No. 89-696 (Colo. Dist. Ct. Douglas County, April 30, 1991).

[84] *See, e.g.*, Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21 (Colo. Ct. App. 1981); Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1977); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616 (Okla. Ct. App. 1982); *see also* Boyster v. Roden, 628 F.2d 1121, 1122 (8th Cir. 1980) (board member of credit association conveyed confidential information that was used to outbid loan applicant on land purchase). A New York court aptly stated:

> [I]f a person applies for a loan, and in connection with that application discloses his purpose to avail of a bargain which he had not as yet closed by contract, and of which the lender had not previously heard, the courts whether of law or of equity would afford some form of adequate relief in case the applicant was forestalled in his project by the lender.

M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 692 (Sup. Ct. 1924). These business opportunity cases resemble the classic corporate opportunity doctrine, insofar as they involve the appropriation of an opportunity rightfully belonging to another. Unlike the corporate opportunity doctrine, however, there is no rule for determining when and under what circumstances a fiduciary lender may compete with a borrower. *Cf.* New v. New, 306 P.2d 987 (Cal. Ct. App. 1957); Guth v. Loft, Inc., 5 A.2d 503 (Del. Ch. 1939); Miller v. Miller, 222 N.W.2d 71 (Minn. 1974).

[85] *E.g.*, High v. McLean Fin. Corp., 659 F. Supp. 1561, 1568 (D.D.C. 1987), *aff'd sub nom.* Hill v. Equitable Trust Co., 851 F.2d 691 (3d Cir. 1988), *cert. denied*, 488 U.S. 1008 (1989); Milohnich v. First Nat'l Bank, 224 So. 2d 759 (Fla. Dist. Ct. App. 1969); Peterson v. Idaho First Nat'l Bank, 367 P.2d 284 (Idaho 1961). The duty to keep information confidential occasionally conflicts with the duty to disclose — for example when two customers of the bank transact business with one another, and the lender is deemed to be a fiduciary of each. *See* Peoples Bank v. Figueroa, 559 F.2d 914, 916-17 (3d Cir. 1977); Hooper v. Barnett Bank, 474 So. 2d 1253, 1259 (Fla. Dist. Ct. App. 1985); Richfield Bank & Trust Co. v. Sjogren, 244 N.W.2d 648, 650 (Minn. 1976).

[86] *See* Dirks v. SEC, 463 U.S. 646, 662 (1983) (the test for breach of fiduciary

C. *The Problem of Imprecision*

Imposing fiduciary duties on a lender effects a major shift in the relationship with the borrower, away from an arms-length commercial relationship and toward one highly protective of the borrower's interests.[87] When does such a relationship arise? The cases are necessarily fact-sensitive, but even with similar facts the results vary. Contrast, for example, the *Brown*, *Camp*, *Rutherford* and *Williams* cases discussed above,[88] each of which found a fiduciary relationship to exist, with *Klein v. First Edina National Bank.*[89] In *Klein*, the putative beneficiary was an alcoholic under additional stress due to the breakup of her marriage. She testified that she trusted the bank, and its employees, as she would trust a doctor or a lawyer.[90] The bank accepted a pledge of her stock to secure a loan made to her employer, not disclosing that her stock was substitute security for an account receivable owed by one Keye. Also undisclosed was the bank's intent to release the Keye account to avoid litigation with Keye, who had just been elected to the board of directors of an affiliated bank.[91] The court rejected, however, the plaintiff's claim of breach of fiduciary duty.

Similarly, in *Stenberg v. Northwestern National Bank*,[92] a borrower took a lender's disastrous financial advice. As a result, his business collapsed. The court rejected a claim of fiduciary duty on the ground that the borrower was capable of exercising independent judgment, and therefore no fiduciary relationship existed with the lender.

Was Ms. Klein's case substantially weaker than Mr. Brown's? Should the borrower's ability to exercise independent judgment be fatal to its claim of breach of fiduciary duty? Meaningful answers to these questions require a coherent theory of fiduciary law. At present, however, courts are unwilling to acknowledge

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duty caused by disclosure of confidential information is "whether the insider personally will benefit, directly or indirectly, from his disclosure"); United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc), *cert. denied*, 112 S. Ct. 1759 (1992).

87 *E.g.*, Deist v. Wachholz, 678 P.2d 188, 195 (Mont. 1984) (observing that a fiduciary lender may "do nothing which would place [the borrower] at a disadvantage").

88 *See supra* notes 77-83 and accompanying text.

89 196 N.W.2d 619 (Minn. 1972).

90 *Id.* at 622.

91 *Id.* at 621.

92 238 N.W.2d 218 (Minn. 1976). *See also* Umbaugh Pole Building Co., Inc. v. Scott, 390 N.E.2d 320 (Ohio 1979).

that such a theory is appropriate. That is, fiduciary law is deliberately imprecise, chiefly because imprecision deters abuses of fiduciary power.[93] The deterrent function of fiduciary law encourages the expectation by fiduciaries that conduct straying close to the edge of acceptability will, in the hindsight of a court, constitute a breach of fiduciary duty. Imprecision, by making the court's actions less predictable, renders borderline conduct too risky.

While such "fiduciary vagueness" may function as intended when applied to conventional fiduciaries, the idea and its supporting rationale should be reexamined before being applied to unconventional fiduciary relationships. There are substantial differences between conventional and unconventional fiduciary relationships, which affect the manner in which this imprecision functions. First, the differences affect a different part of the analysis in a conventional fiduciary case than they do in an unconventional case. Second, in a conventional case, the positions of the parties, and their respective expectations, are markedly different from their counterparts in an unconventional case.

In a conventional fiduciary relationship, the major area of imprecision lies in defining the scope of the fiduciary's duty to the beneficiary.[94] This is dictated by the nature of the relationship — fiduciary status is its defining characteristic, and the ambiguities exist in deciding what that status means in relation to the parties. For example, if it is claimed that a corporate director misappropriated for her personal benefit an opportunity properly belonging to the corporation, the most hotly contested issues will be whether the opportunity was in fact corporate, and if

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[93] "Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish." Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928) (Cardozo, C.J.); *see* High v. McLean Fin. Corp., 659 F. Supp. 1561, 1568 (D.D.C. 1987), *aff'd sub nom.*, Hill v. Equitable Trust Co., 851 F.2d 691 (3d Cir. 1988), *cert. denied*, 488 U.S. 1008 (1989); Pryor v. Bistline, 30 Cal. Rptr. 376, 381 (Cal. Ct. App. 1963) (quoting 23 AM. JUR. *Fraud & Deceit* § 14, at 764); Committee on Children's Television, Inc. v. General Foods Corp., 673 P.2d 660, 675, (Cal. 1983); Dale v. Jennings, 107 So. 175, 179 (Fla. 1925); Kurth v. Van Horn, 380 N.W.2d 693, 698 (Iowa 1986); Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982); M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 689 (Sup. Ct. 1924) (fiduciary doctrine applies "[w]herever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and . . . influence . . . is possessed by the other") (citation omitted); SHEPHERD II, *supra* note 2, at 142-44, 341-42; Shepherd I, *supra* note 2, at 56; *cf.* Finn, *supra* note 5, at 1; Frankel, *supra* note 3, at 811 (purpose of fiduciary law is to protect beneficiary from abuse of power); SHEPHERD II, *supra* note 2, at 3-4.

[94] *See* Shepherd I, *supra* note 2, at 51-52.

so, whether the director took the steps required before she is permitted to exploit personally the opportunity. Both of these concern the scope of fiduciary duty, rather than the existence of a fiduciary relationship. Little time will be spent arguing that the director was not a fiduciary of the corporation.[95]

In an unconventional fiduciary case, by contrast, the ambiguity arises primarily in the question whether the relationship is fiducial at all. Courts deciding unconventional fiduciary cases usually do not spend much time defining the scope of the duties owed by the fiduciary. The determination that an unconventional fiduciary relationship exists almost inevitably is followed by the conclusion that the concomitant fiduciary duty was breached.[96] Consequently, the nature of the relationship constitutes the central issue in an unconventional fiduciary case.[97]

Next, one must keep in mind the positions of the parties in an unconventional fiduciary case. Before the determination that the relationship is fiducial, the lender-borrower relationship is legally an arms-length, creditor-debtor relationship. Both sides

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95 The ambiguity in conventional fiduciary relationships arises both from the deliberate imprecision of fiduciary analysis (i.e. that the rules applicable to corporate opportunity are deliberately left somewhat unclear) and from the failure of fiduciary law to follow fiduciary rhetoric. While courts continue to espouse the "punctilio of an honor the most sensitive," the standard has evolved into one that, for many fiduciary relationships, is less rigorous. *See* Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); Mitchell, *supra* note 5, at 1688. Our hypothetical director may succeed in establishing a defense, notwithstanding that her honor may have been somewhat less sensitive than the rhetoric would require.

96 *But see* Atlantic Nat'l Bank v. Vest, 480 So.2d 1328 (Fla. Dist. Ct. App. 1985). In *Atlantic*, a borrower financed the purchase of an automobile and gave the lender his note to evidence the debt. The plaintiff, co-signer of the note, as well as the borrower's stepfather, inquired of the lender what would be the legal consequence, from the standpoint of tort liability, of having title to the automobile placed in his name "or" the name of his stepson. The banker stated that she did not know, but at plaintiff's request inquired of his insurance agent. The agent gave the banker erroneous advice and she passed the advice on to the plaintiff. When the stepson was involved in an accident, the plaintiff was held liable as a co-owner of the vehicle, and he sued the bank for indemnity. The appellate court held that, although the request for advice could have produced a fiduciary obligation on the part of the bank, any such obligation was discharged by the banker when she stated that she did not know the answer. *Id.* at 1333. The court concluded that it was reversible error not to direct a verdict for the bank. *Id.*

97 The manner of resolving this issue is itself not free from doubt. The question of whether a commercial relationship has evolved into an unconventional fiduciary relationship has been variously held to be a question of law, Dale v. Jennings, 107 So. 175, 177 (Fla. 1925), a question of fact, Kurth v. Van Horn, 380 N.W.2d 693, 695 (Iowa 1986), and a mixed question of law and fact, Hooper v. Barnett Bank, 474 So. 2d 1253, 1257-58 (Fla. Dist. Ct. App. 1985).

undertake to maximize their benefit while keeping the their cost (including, in the case of the lender, the risk of default) as low as possible. The relationship between risk to the lender and cost to the borrower is quite clear and well-understood; the riskier the loan, the higher the cost to the borrower, whether in terms of interest rate, fees or other mechanisms designed to produce return on the lender's asset, the loan.[98] The interests of the lender and the borrower are in conflict, but this is expected and accommodated in their relationship. When the relationship evolves into a fiduciary relationship, however, the creditor-debtor relationship is not extinguished but continues, along with the parties' conflicting interests. Thus, the unconventional fiduciary relationship begins with an actual conflict of interest between the fiduciary and the beneficiary. This is quite unlike the conventional fiduciary relationship, in which such a conflict of interest would disqualify the fiduciary from assuming fiduciary duties.

These differences between conventional and unconventional fiduciary relationships weaken substantially the rationale for fiduciary vagueness in unconventional fiduciary cases. Persons entering into an unconventional fiduciary relationship do not, by definition, expect fiduciary standards to govern their conduct. Because the relationship at its inception is an ordinary, arms-length commercial relationship, both parties may be expected to pursue their own interests exclusively. Vagueness about the circumstances under which this relationship will become fiducial means that the maybe-fiduciary is kept in the dark as to what standards will govern its conduct vis-a-vis the maybe-beneficiary. At the same time, there is a clear conflict between the parties' respective interests. Under these circumstances, the rational maybe-fiduciary will choose to act in its own self-interest. This result can be avoided only by increasing the likelihood that the relationship will be governed by fiduciary standards, and more importantly, by increasing the predictability of the applicable standard of conduct. Thus, only when an unconventional fiduciary believes that a court will most probably hold it to fiduciary standards will the fiduciary modify its conduct to conform to fiduciary standards. This outcome becomes increasingly likely as the maybe-fiduciary's ability to predict what standards will govern its conduct improves. Conversely, to the extent that vagueness diminishes the maybe-fiduciary's ability to predict that it will be held to fiduciary standards, the likelihood that it will in fact com-

98 *See* Fischel, *supra* note 17, at 136.

ply with fiduciary standards decreases. Under existing law, lack of foreknowledge that fiduciary standards will govern the relationship makes a breach of fiduciary duty practically inevitable. The utility of "fiduciary vagueness" in deterring self-interested conduct depends completely upon the ostensible fiduciary's knowledge of fiduciary status.

What is the impact, then, of "fiduciary vagueness" in an unconventional fiduciary case? First, by enabling substantive judicial review of the contract terms, it provides an opportunity for a disappointed party to escape the strictures of a contract.[99] Second, it encourages litigation by making each case fact-bound. Third, in some cases, it needlessly prolongs litigation; the doctrine is so fact-specific that a defensive assertion of breach of fiduciary duty can sometimes forestall a grant of summary judgment to a lender that otherwise would have an entirely uncomplicated action on a note.[100]

While it might be argued that lenders could avoid the application of fiduciary standards simply by not engaging in the riskiest kinds of conduct, such as giving business advice to their borrowers, it is unlikely that lenders could in fact avoid this conduct and remain competitive.[101] Given the choice between a lender willing to share its business expertise and one unwilling to do so, a borrower would most probably choose the former. This outcome should be encouraged because both parties are best served by permitting those expert in business to practice their

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[99] Of course, other options to accomplish this result may exist in a particular case. The equitable doctrine of unconscionability, for example, can have the same effect. Unconscionability, however, focuses on the terms of the agreement, which must "shock the conscience" of the court before relief will be granted. An agreement with terms that are standard in the industry is therefore relatively unlikely to be invalidated on grounds of unconscionability. A claim of unconventional fiduciary relationship can still succeed, however, because it is independent of the terms of the agreement.

[100] Allegations of breach of fiduciary duty are sometimes made in a manner that suggests a "best defense is a good offense" approach to litigation strategy. Thus, when a borrower defaults on a loan, it may choose to go on the attack with charges that the lender breached a fiduciary duty owed to the borrower. Asserting such a claim will at least buy time for the borrower. *See, e.g.*, Hunt v. Bankers Trust Co., 689 F. Supp. 666, 675 (N.D. Tex. 1987) (breach of fiduciary duty claim against lenders survived a motion for summary judgment, notwithstanding that the borrowers were sophisticated businessmen, having borrowed $1.85 *billion*). At best it may net the borrower a substantial recovery. *See* Callis v. Mellon Bank, No. 89-696 (Colo. Dist. Ct. Douglas County April 30, 1991) (award of $41.8 million actual damages and $23.6 million punitive damages based on breach of fiduciary duty).

[101] *See supra* notes 53-66 and accompanying text.

expertise.[102]

At a minimum, failure to clarify the circumstances under which a commercial relationship becomes fiducial raises the cost of borrowing to those least able to pay.[103] The smaller, riskier borrowers are most likely to be affected, but they are the borrowers most needing the expertise and financial sophistication that an experienced lender can provide. At the same time, they are the ones most likely to fail and thus are most likely to bring lender liability actions claiming breach of fiduciary duty.

IV. RETHINKING THE LENDER'S FIDUCIARY DUTY

Courts have offered little guidance to borrowers or lenders concerning what conduct will transform the lender-borrower relationship into a fiduciary relationship. The cases also demonstrate some confusion as to which factors properly support a finding that the lender-borrower relationship has been transformed into a fiduciary relationship, and which are relevant to the claim that the fiduciary duty has been breached. Fiduciary law could better achieve its goals if the inquiry proceeded with more direction.

While it is tempting to second-guess the existing cases to demonstrate their possible flaws, this Article attempts this only a little. Indeed, because the existing cases have adopted a traditional and vague analysis, there is very little that is conceptually "right" about them. It is not instructive to point to a holding reached by traditional means and pronounce it correct or incor-

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102 *See* Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937).

103 *See* SHEPHERD II, *supra* note 2, at 144; *see generally* Fischel, *supra* note 17, at 133 (describing the economics of lending and the lender-borrower relationship). While it could be argued that lenders ought to assume that they are fiduciaries of their borrowers and thus should conform their conduct to fiduciary standards, this, too, would inevitably raise the cost of borrowing and would distort fundamentally the nature of commercial lending. Although no such argument has been presented by any court imposing fiduciary standards upon a lender, a California court, in Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551 (Cal. Ct. App. 1985), held that the relationship between a bank and a *depositor* is "at least quasi-fiduciary." *Commercial Cotton*, 209 Cal. Rptr. at 554. The bank was held to be bound by a corresponding "quasi-fiduciary duty" to the depositor. *Id.*

In the bank-depositor relationship, however, the bank is the debtor. Extending this principle to the lender-borrower relationship could result in the debtor (i.e. the borrower) owing fiduciary obligations to the lender; for example not to waste funds that could be used to repay the debt. Although the current state of fiduciary law in the United States makes this result unlikely, the fiduciary doctrine has been applied in this way in lender cases in Australia. *See* Finn, *supra* note 5, at 109 (citing cases); *see also* SHEPHERD II, *supra* note 2, at 25 & n.18.

rect; it is the underpinnings of the result that are most relevant. Additionally, the very ambiguity of the traditional analysis tends to produce findings of fact that support the results reached. When courts state that "we will not be confined to specific principles," they are also saying that their freedom to decide cases based on their instincts of fairness will not be impaired. It is, of course, incontestable that fiduciary law should be fair, but fairness requires that outcomes be at least somewhat predictable, and this is especially true for unconventional fiduciary cases.

A. Theory's Contribution

The theory of fiduciary law provides the foundation for the approach to be used in determining that a relationship has become fiducial. It is therefore useful to begin with fiduciary theory, and then to evaluate the application of specific factors that recur in the unconventional fiduciary cases.

Fiduciary theory focuses on the fiduciary's power over some specific aspect of the beneficiary's existence; the potential for abuse of that power justifies the application of fiduciary principles. This has several implications for the analysis of unconventional fiduciary cases. Notably, the terms of an agreement between the fiduciary and the beneficiary negotiated *before* the fiduciary relationship arose should be presumed to be enforceable and arms-length.[104] Such agreements do not present the dangers against which fiduciary law guards; protection against the abuse of fiduciary power in negotiating the terms of an agreement is inappropriate when fiduciary power was itself absent at the time of the negotiation. For example, superior bargaining power existing at the inception of a lender-borrower relationship may lead to the borrower's agreement to terms that, in hindsight, it finds unacceptable. The terms are nonetheless presumptively valid. The exercise of superior bargaining power in establishing a relationship does not itself violate any fiduciary duties,[105] nor does it cause an otherwise arms-length relationship to become fiducial.[106] Superior bargaining power is a routine incident of most

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104 *See* Frankel, *supra* note 3, at 819 n.75.

105 *See* Weinrib, *supra* note 2, at 6. If the parties are already in a fiduciary relationship at the time the terms of a loan are negotiated, then exercising superior bargaining power to gain an advantage over the beneficiary would, of course, constitute undue influence over the beneficiary and would violate fiduciary obligations.

106 Committee on Children's Television, Inc. v. General Foods Corp., 673 P.2d 660 (Cal. 1983). Shepherd disagrees, pointing out the close resemblance between

commercial and financial transactions. To impose fiduciary obligations upon all parties exercising superior bargaining power would "largely displace both the tort of fraud and much of the [Uniform] Commercial Code."[107] Moreover, to do so would unacceptably penalize business success, because the enhanced bargaining power that results from success would soon make it impossible for the successful party to contract on non-fiduciary terms.

While the use of superior bargaining power to obtain a commercial advantage does not inevitably produce an enforceable bargain, such use does not give rise to a fiduciary relationship. An imbalance of power existing before the relationship's establishment is best described and dealt with by contract doctrines[108] such as duress[109] and unconscionability.[110] These doctrines are just as vague as fiduciary principles, but that certainly is no reason to treat them all as interchangeable. By requiring proper characterization of the doctrines that govern the cases, those doctrines, whether fiduciary relationship, unconscionability or duress, will have the opportunity to evolve in a coherent manner.

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abuse of power when one party overbears the other in contract negotiations, and when a fiduciary secures the beneficiary's consent to terms favoring the fiduciary in a transaction. *See* SHEPHERD II, *supra* note 2, at 233-34. Recognizing that almost all transactions involve some degree of inequality, Shepherd nevertheless draws the startling conclusion that "the stronger party cannot be deprived of his bargain *if he has not taken advantage of the inequality . . . to gain an advantage in the transaction*." *Id.* at 232 (emphasis added). Precisely what this is intended to mean is unclear; certainly, few if any transactions permit the inference that the stronger party did not secure some advantage from its position of strength.

[107] Committee on Children's Television, Inc. v. General Foods Corp., 673 P.2d 660, 675 (Cal. 1983).

[108] For a summary of contract doctrines that protect vulnerable parties against overreaching and other misbehavior, as well as a useful comparison with fiduciary principles, *see* DeMott I, *supra* note 2, at 903-08.

[109] *See* Ismert & Assocs., Inc. v. New England Mut. Life Ins. Co., 801 F.2d 536 (1st Cir. 1986); Int'l Halliwell Mines, Ltd. v. Continental Copper & Steel Indus., Inc., 544 F.2d 105 (2d Cir. 1976); Republic Nat'l Life Ins. Co. v. Rudine, 668 P.2d 905 (Ariz. Ct. App. 1983); Pleasants v. Home Fed. Sav. & Loan Ass'n, 569 P.2d 261 (Ariz. Ct. App. 1977); Mountain Elec. Co. v. Swartz, 393 P.2d 724 (Idaho 1964); Inland Empire Refineries, Inc. v. Jones, 206 P.2d 519 (Idaho 1949); Gerber v. First Nat'l Bank, 332 N.E.2d 615 (Ill. App. Ct. 1975); Pecos Constr. Co. v. Mortgage Inv. Co., 459 P.2d 842 (N.M. 1969); Donald v. Davis, 163 P.2d 270 (N.M. 1945); Simpson v. Mbank Dallas, 724 S.W.2d 102 (Tex. Ct. App. 1987); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984); Starks v. Field, 89 P.2d 513 (Wash. 1939).

[110] *See, e.g.*, Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948); Weaver v. American Oil Co., 276 N.E.2d 144 (Ind. 1971); Wille v. Southwestern Bell Tel. Co., 549 P.2d 903 (Kan. 1976); Hy-Grade Oil Co. v. New Jersey Bank, 138 N.J. Super. 112, 350 A.2d 279 (App. Div. 1975).

There is nothing to be gained by broadening fiduciary law to apply to all aspects of commercial transactions.

The foregoing provides some general guidance for determining whether a fiduciary relationship exists between a lender and a borrower. The next part of this Article examines more specifically the factors courts have weighed in cases alleging fiduciary relationships between lenders and borrowers.

B. Factors in Unconventional Fiduciary Cases

1. Factors Relating to the Existence of Fiduciary Power

In the typical lender case, the lender's giving financial or business advice constitutes the conduct most directly connected to fiduciary power. Merely giving advice, however, does not result in control over an aspect of the borrower's existence. Two additional factors are required before fiduciary power can properly be said to exist in a lender: first, reliance upon the advice; and second, the lender's knowledge, or in some cases presumed knowledge, of that reliance. The first is necessary for fiduciary power to exist, and the second is needed, as a practical matter, to demonstrate acceptance of that power by the fiduciary.

a. *Power Over the Beneficiary*

Most courts facing lender fiduciary claims agree that power over the borrower by the lender is an important factor, and some courts have found it to be indispensable.[111] The cases are not uniform, however, in determining what kind of power suffices as fiduciary power. Some courts find unequal bargaining power — that is, superior power in the lender to influence the terms of the credit agreement — sufficient.[112] As already discussed, such a holding is inconsistent with principles of fiduciary law; bargaining power is not a substitute for fiduciary power. To the extent that their holdings rest on unequal bargaining power, these cases were wrongly decided.

Borrowers occasionally argue that their particular vulnerability, known to the lender, resulted in domination by the lender and therefore a fiduciary standard of conduct should be im-

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[111] *See, e.g.*, Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982); Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989); Production Credit Ass'n v. Croft, 423 N.W.2d 544, 547 (Wis. 1988).

[112] *E.g.*, Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985); *Denison State Bank*, 640 P.2d at 1243; Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 619 (Okla. Ct. App. 1982).

posed.[113] This circumstance should not suffice to support a claim of domination by the alleged fiduciary unless the claimed vulnerabilities are related specifically to the acts cited to support the relationship's fiduciary nature. Thus, in the *Klein* case discussed above,[114] the court remarked that the plaintiff was an alcoholic and acknowledged expert testimony at trial to the effect that "a predominant factor in plaintiff's psychological makeup was a need to please and a susceptibility to suggestion."[115] The court did not, however, accord any weight to these facts because there was no evidence linking them to the lender's acts that purportedly resulted in fiduciary duty to the borrower.[116] The result should be different, however, if it were shown that the lender exercised power in a manner related to the plaintiff's vulnerability. To use an extreme example, evidence that a lender served a borrower, whom it knew to be alcoholic, a few drinks before discussing the borrower's business would be relevant to the existence of a fiduciary relationship.

b. *Reliance Upon the Lender*

In conventional fiduciary cases, courts do not usually require proof that the beneficiary actually trusted the fiduciary. Indeed, the beneficiary's subjective state of mind is unimportant. The rebuttable presumption of undue influence establishes that the fiduciary had influence over the beneficiary.[117]

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113 *E.g.*, Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619, 621 (Minn. 1972).

114 *See supra* notes 89-90 and accompanying text.

115 Klein v. First Edina Nat'l Bank, 108 N.W.2d 619, 621 (Minn. 1972).

116 A different rule would require that anyone dealing with a person having such a vulnerability be a fiduciary of that person, in effect foreclosing such transactions. *See* SHEPHERD II, *supra* note 2, at 136-37, 144. "To take just one example, the elderly would never be able to borrow money, since no lender in his right mind would make a loan in which responsibility for all facets of the transaction rested with the lender." *Id.* at 229-30 (footnote omitted). On the other hand, there are presently certain doctrines of contract law that function in a similar manner. Minors, for example, may avoid contractual obligations. Although this has undoubtedly reduced the number of contracts made with minors, such agreements are still made, for example in the entertainment business. *See, e.g.*, Warner Bros. Pictures, Inc. v. Brodel, 192 P.2d 949 (Cal.), *cert. denied*, 335 U.S. 844 (1948). California, a state in which the ability of minors to disaffirm contracts might be expected to produce unusual difficulties, has enacted statutes providing that minors may not disaffirm entertainment contracts providing the contract was made with judicial approval. CAL. CIV. CODE § 36 (West 1989) (contracts for artistic and creative services); CAL. LAB. CODE § 1700.37 (West 1989) (contracts with talent agencies).

117 *See supra* notes 75-76 and accompanying text. Realistically, conventional fiduciary relationships pose the problem of abuse of power whether or not subjective reliance exists. *See* Frankel, *supra* note 3, at 824-25. A trustee has power over the

In lender fiduciary cases, by contrast, courts have frequently required that the borrower repose trust or, as it is often expressed, "trust and confidence," in the lender before a fiduciary relationship will arise.[118] To establish a fiduciary relationship, the putative beneficiary is required to demonstrate its subjective faith in — its reliance on — the ostensible fiduciary. There are, however, wide variations in the degree or amount of trust that must be demonstrated. Most courts require a showing that the lender gave advice specific to the transaction in question, and that the borrower justifiably relied on that advice.[119] A few cases have resisted the conclusion of fiduciary relationship, even with evidence that the lender regularly advised the borrower, and that the borrower followed this advice.[120] At the other extreme, some courts suggest that a lender's holding itself out as a trustworthy advisor may satisfy the "reposing trust and confidence" requirement.[121] In one case, a relationship that merely induced one party "to relax the care and vigilance it would and should have ordinarily exercised in dealing with a stranger" was enough.[122]

A subjective reliance requirement is justifiable in unconventional fiduciary cases, even though there is no such requirement in conventional cases. Conventional fiduciary relationships signal both parties' understanding that the fiduciary is bound to act in the beneficiary's best interest. There is no need for separate

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beneficiary of the trust, whether or not the beneficiary has the slightest subjective faith in the trustee.

118 *See, e.g.*, Barrett v. Bank of Am., 229 Cal. Rptr. 16, 20 (Cal. Ct. App. 1986); Dale v. Jennings, 107 So. 175, 178 (Fla. 1925); Atlantic Nat'l Bank v. Vest, 480 So. 2d 1328, 1333 (Fla. Dist. Ct. App. 1985); Bank Comp. Network Corp. v. Continental Ill. Nat'l Bank & Trust Co., 442 N.E.2d 586, 594 (Ill. App. Ct. 1982); First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970); Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982); Smith v. Saginaw Sav. & Loan Ass'n, 288 N.W.2d 613, 618 (Mich. Ct. App. 1979); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619, 622 (Minn. 1972); Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989).

119 *See Barrett*, 229 Cal. Rptr. at 20; Earl Park State Bank v. Lowmon, 161 N.E. 675, 679 (Ind. Ct. App. 1928); Kurth v. Van Horn, 380 N.W.2d 693, 697-98 (Iowa 1986); *Denison State Bank*, 640 P.2d at 1243; Dugan v. First Nat'l Bank, 606 P.2d 1009, 1015 (Kan. 1980); *Smith*, 288 N.W.2d at 618.

120 *E.g.*, Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989) (advice not enough, absent control); Production Credit Ass'n v. Croft, 423 N.W.2d 544, 548 (Wis. 1988) ("A fiduciary relationship does not arise merely because advice and counsel is offered upon which a customer places trust and confidence.").

121 Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937) ("friendship" for depositor); Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 23 (Colo. Ct. App. 1981); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 620 (Okla. Ct. App. 1982).

122 *Dolton*, 642 P.2d at 23 (quoting United Fire & Cas. Co. v. Nissan Motor Corp., 433 P.2d 769, 771 (Colo. 1967)).

indicia that the fiduciary violated a relationship based upon trust. Unconventional relationships, in contrast, grow out of the ordinary, commercial relationships, in which one party may, and usually does, have power over the other. But this power is not fiduciary power. What distinguishes garden-variety commercial power from fiduciary power is the putative beneficiary's reasonable expectation that the power will be used only for the beneficiary's benefit. In the absence of that subjective trust, or a substitute such as coercive pressure,[123] power in a commercial relationship remains merely commercial power, regardless of which party holds the upper hand at various times in the relationship.[124] Power exercised without breach of trust is not a violation of fiduciary duty.

In the lender cases, probably the most common evidence introduced in support of "trust reposed" is the borrower's voluntary adoption of the lender's advice. This factor, without coercive pressure from the lender, suggests that the borrower trusted the lender. The quality of the advice is not in issue; what is important is whether the borrower reasonably expected that the lender was providing advice intended to benefit the borrower.

Rather than being a separate component of an unconventional fiduciary relationship, then, reliance on the fiduciary is an important factor in establishing fiduciary power in an unconventional fiduciary relationship. If the advised does not trust the advisor, the advice will most likely be ignored, and fiduciary power is absent.[125] Reliance provides the necessary support for a finding of fiduciary power in the lender.

The weight that should be given to evidence of the borrower's reliance on the lender depends upon both the quantity and the importance of the lender's advice. An isolated incident does not support a finding of a fiduciary relationship unless the advice was of unusual significance. A person may choose to follow another's advice on one or a few occasions without reposing

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123 *See infra* Part IV, sec. B.2, at 58.

124 *See* Shepherd I, *supra* note 2, at 75.

125 The relationship between reliance and power may have eluded the court in A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285 (Minn. 1981), a case basing lender liability upon agency law. The *Cargill* court emphasized that Cargill controlled its debtor, based, among other factors, on "Cargill's constant recommendations to [the debtor]" and "Cargill's correspondence and criticism regarding [the debtor's affairs]." *Id.* at 291. The court's own earlier observation that most of Cargill's recommendations were not followed, *id.* at 289 n.4, was not evaluated in terms of its implications for Cargill's power.

trust in the other. Such conduct may merely be the result of coincidence (for example, where the advised party independently concludes that a specific course of action is desirable) or of a "let's see how it goes" attitude. On the other hand, a pattern of taking advice from the lender, especially regarding matters important to the borrower, suggests that the borrower has entrusted confidence in the lender.[126]

c. *Acceptance of Power*

A party should be bound by fiduciary ties to another only if the party has voluntarily assumed the fiduciary role. Fiduciary power cannot be imposed on a party against its will, or without its knowledge.[127] The ostensible fiduciary must have accepted the fiduciary power entrusted to it, and this requirement exists for both conventional and unconventional fiduciary cases. This

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[126] In some cases lenders, by advising borrowers, may also breach fiduciary duties owed to third parties, such as other creditors of the borrower or the borrower's shareholders. *See, e.g.*, Pepper v. Litton, 308 U.S. 295 (1939); *In re* Otis & Edwards, P.C., 115 B.R. 900 (Bankr. E.D. Mich. 1990); *In re* EMB Assocs. Inc., 92 B.R. 9 (Bankr. R.I. 1988); *In re* Vietri Homes, Inc., 58 B.R. 663 (Bankr. Del. 1986). The circumstances under which such fiduciary duties may arise are as ill-defined as those under which a fiduciary duty to the borrower arises, and they are amenable to the same sort of analysis proposed here. Such fiduciary relationships should not be deemed to exist unless appropriate showings of power and trust can be made. This would necessarily limit the situations in which, for example, third-party creditors could successfully claim breach of fiduciary duty, but other doctrines are available to protect them. Preferential transfer and fraudulent conveyance law, for example, are frequently alleged in cases of abuse by a dominant creditor. *E.g.*, Kniffin v. Colorado W. Dev. Co., 622 P.2d 586 (Colo. Ct. App. 1980) (preferential transfer); First Nat'l Bank & Trust v. Manning, 164 A. 881 (Con. 1933) (preferential transfer); Jasson D. Radding, Inc. v. Coulter, 138 So. 2d 380 (Fla. Dist. Ct. App. 1962) (preferential transfer); Crawford County State Bank v. Marine Am. Nat'l Bank, 556 N.E.2d 842 (Ill. App. Ct. 1990) (fraudulent conveyance); Francis v. United Jersey Bank, 162 N.J. Super. 355, 392 A.2d 1233 (Law Div. 1978), *aff'd*, 87 N.J. 15, 432 A.2d 814 (1981) (fraudulent conveyance); Rainier Nat'l Bank v. McCracken, 615 P.2d 469 (Wash. Ct. App. 1980) (fraudulent conveyance). These suffice for most such cases. Where they do not, the application of fiduciary principles to provide a remedy, at the cost of further muddying fiduciary law, is an example of the cure being worse than the disease.

[127] *See* Finn, *supra* note 5, at 9; Frankel, *supra* note 3, at 820-21. The courts, by and large, have agreed. *See* Dale v. Jennings, 107 So. 175, 178 (Fla. 1925); Bank Comp. Network Corp. v. Continental Ill. Nat'l Bank & Trust Co., 442 N.E.2d 586, 594 (Ill. App. Ct. 1982); Denison State Bank v. Madeira, 640 P.2d 1235, 1244 (Kan. 1982); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619, 623 (Minn. 1972); Umbaugh Pole Bldg. Co. v. Scott, 390 N.E.2d 320, 323 (Ohio 1979) (fiduciary relationship is created out of informal relationship "only when both parties understand that a special trust or confidence has been reposed"); *see* M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 692 (Sup. Ct. 1924) ("[n]o man can obtrude either his trust or his secrets upon another").

does not mean that the *status* of fiduciary must be accepted; only the power need be accepted. The law draws the conclusion of status based upon the existence and acceptance of fiduciary power. Likewise, fiduciary duty itself need not be accepted; it suffices that the fiduciary accepted fiduciary power. The power carries with it the corresponding duty.[128]

The fiduciary, then, must voluntarily assume fiduciary power; thereafter fiduciary duty attaches. No such principle applies to the beneficiary, however. Although in many cases the beneficiary will have voluntarily transferred fiduciary power to the fiduciary, such as by accepting the fiduciary's advice free of coercion, in other cases the fiduciary will have seized fiduciary power from the beneficiary, for example by forcing advice on the beneficiary. There is no real inconsistency here: fiduciary principles protect the beneficiary, which in any case has the option to decline to enforce its rights as beneficiary. From the beneficiary's point of view, even when its transfer of fiduciary power is not voluntary, its enforcement of fiduciary obligations is.

The requirement that the lender accept fiduciary power can be satisfied in various ways. Evidence demonstrating, for example, that the lender undertook expressly to act in the borrower's behalf would tend to show acceptance of fiduciary *status*. Accepting fiduciary status includes accepting fiduciary power. In addition, use of fiduciary power, with knowledge of the beneficiary's reliance on the fiduciary, constitutes acceptance of the power.[129]

Finally, acceptance of fiduciary power also exists when the lender has misused the borrower's confidential information. The use of the information for the lender's benefit, or to the borrower's detriment, demonstrates the necessary acceptance. The existence of power over the borrower is inherent in the nature of confidential information, which generally is confidential because of the potential for financial, reputational or other damage to the beneficiary that could result from its misuse.

2. Distinguishing Fiduciary Power from Commercial Power

What is fiduciary power, and how is it to be distinguished from ordinary, commercial power? In unconventional cases, this issue is the central question with which the court must grapple.

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[128] SHEPHERD II, *supra* note 2, at 101.

[129] SHEPHERD II, *supra* note 2, at 101-02 & n.22; Shepherd I, *supra* note 2, at 76.

Fiduciary theory to date has described fiduciary power as one that is "encumbered" by an obligation to use the power only for the beneficiary's benefit,[130] but how are we to know when the power is encumbered?

Fiduciary power — and, therefore, a fiduciary relationship — exists when power to affect some aspect of the beneficiary's existence is transferred to the fiduciary. The beneficiary reasonably relies on the power being used solely for the beneficiary's benefit, and the fiduciary knows of the beneficiary's reliance. In conventional cases, a conclusive presumption of the beneficiary's reliance is workable and produces an "encumbered power." In unconventional cases, however, such a presumption is not useful, because the power transferred will not be immediately recognizable as fiduciary power, so as to bring the presumption into operation.

In unconventional cases, actual reliance substitutes for the presumption of reliance. But the beneficiary's reliance must be reasonable. Thus, a borrower should not succeed with a claim that it relied upon the lender's exercising an acceleration power solely for the borrower's benefit. Such a claim is manifestly unreasonable.

What of the case in which there is no reliance, because the lender *seized* power that, had it been voluntarily surrendered, would certainly have been surrendered on the condition that it be used only for the borrower's benefit? The advisory power is an example: the lender may force business advice on the borrower. In such a case, reliance need not be shown. Reliance would be inevitable in a voluntary transfer of such power; the fiduciary should not be permitted to obtain by coercion what it cannot obtain by legitimate means.

Acceptance by the ostensible fiduciary can be dealt with in a similar fashion. Because acceptance is a subjective factor, one should not expect lenders frequently to concede their acceptance of fiduciary power. If, however, the lender was aware of the beneficiary's reasonable expectation that the power transferred would be exercised only for the beneficiary's benefit, then exercise of the power, whether or not consistent with that expectation, should be deemed acceptance of the fiduciary power. In proving awareness of that expectation, a presumption may help. The ostensible fiduciary should be presumed to be aware of the

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130 SHEPHERD II, *supra* note 2, ch. 6.

beneficiary's reliance if a reasonable fiduciary in the same position would have been aware of it.[131]

To summarize, fiduciary power may be distinguished from commercial power by the beneficiary's reasonable expectation that the power transferred will be exercised only for the beneficiary's benefit. When equivalent power is seized, such subjective reliance need not be shown. The fiduciary must accept fiduciary power. Exercise of the power with knowledge, or presumed knowledge, of the beneficiary's reliance suffices to show acceptance.

An example may clarify this point. Suppose a borrower independently makes a series of imprudent business decisions. Each decision diminishes its financial resources, and the cumulative effect is to place the borrower in violation of certain financial covenants contained in its loan agreement. Violation of these covenants makes the borrower ineligible for additional loans under the loan agreement. These facts raise no inference of fiduciary relationship. The lender's power to withhold additional financing is not fiduciary power, but rather results from the lender's exercise of bargaining power in establishing the commercial relationship with the borrower. The borrower has no reasonable expectation that the lender's power will be used for the borrower's benefit, and therefore the elements of reliance and acceptance are missing. The lender's refusal to loan additional funds is not, in the absence of a fiduciary relationship, a breach of fiduciary duty.[132]

Now suppose that the lender, by threatening to withhold funding, exerts pressure on the borrower to make the same financial decisions. Unable to resist, the borrower acquiesces. In this case, the relevant power of the lender is not the power to withhold financing, as it was in the first example, but rather is the power to compel the borrower to accept the lender's financial advice. Although the reliance element is absent, the borrower would not voluntarily have transferred advisory power to the lender without relying on the lender to exercise the power to benefit only the borrower. Coercion substitutes for reliance. The lender's exercise of the power constitutes acceptance of the power. Thus, this example presents both essential questions in

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[131] SHEPHERD II, *supra* note 2, at 102.

[132] This in no way, however, shields the loan covenants from analysis to determine whether they are unconscionable, nor does it prevent the agreement process from being scrutinized for evidence of duress.

fiduciary analysis: was the relationship fiducial, and, if so, then was the resulting duty of loyalty breached? The facts are too sparse to answer either question conclusively, but the important point is that issues of fiduciary relationship are presented in the latter scenario, but not in the former.[133]

The factors examined above are all part of a showing that fiduciary power existed in the lender, rather than separable components of a fiduciary relationship. Failure to prove one of these three elements amounts to a failure to demonstrate that fiduciary power existed in the lender at all, or was accepted by the lender, rather than a failure to prove a separate and essential element of a fiduciary relationship.

This approach to the problem focuses the analysis on the nature of the fiduciary relationship and emphasizes the feature that makes it different from an ordinary commercial relationship — the potential for abuse of fiduciary power. In addition, it is more structured than the traditional approach, and it demystifies the concept of the unconventional fiduciary relationship. It thereby furthers the goals of fiduciary law by enabling lenders to better evaluate the likelihood that they have become fiduciaries. Also, by focusing on significant underlying concepts, rather than on relatively undifferentiated "factors," it furthers the coherent development of fiduciary law.

3. Other Factors

The remaining factors courts emphasize when considering lender fiduciary cases tend to fall into two groups: those that provide evidentiary support for fundamental elements of the fiduciary relationship, and those that relate to the question of breach of duty in a relationship that has already been shown to be fiducial.

a. *Duration of the Relationship*

Courts have paid some attention to the duration of the relationship between the lender and the borrower, but the results have been inconsistent. While one court found a relationship of twenty-four years significant in determining that the lender was a fiduciary,[134] another found a relationship of twenty years

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[133] The lender may also, by this conduct, breach various implied contractual duties. These occasionally have been elevated to the status of "torts" closely resembling breach of fiduciary duty. *See supra* note 74.

[134] Deist v. Wachholz, 678 P.2d 188, 193 (Mont. 1984).

insufficient.[135]

Duration of the lender-borrower relationship merely evidences the existence of trust; it has no independent existence as an element of a fiduciary relationship. Although it may be more likely that a borrower will trust a lender with whom it has a long-term relationship, there is no requirement of fiduciary law or theory that the relationship have existed for any particular period of time. A fiduciary relationship clearly can spring into existence in a short time. For example, a trustee who applies the corpus of the trust for her own benefit within minutes of her appointment has breached her fiduciary duty as surely as one who waits for years before misapplying funds.[136]

b. *"Improper Benefit"*

Some courts have considered receipt by the lender of a benefit extrinsic to the loan agreement to be relevant to a claim of fiduciary obligation.[137] While the cases frequently reflect lender conduct that is inequitable at best, the conduct frequently is not probative of the existence of a fiduciary relationship. Often, the "improper benefit" involves improvement of the lender's position in an unrelated transaction. Thus, in *Hooper v. Barnett Bank*,[138] a surgeon sued a lender that financed an investment in a tax shelter. The lender was apparently aware, but did not disclose, that the tax-shelter promoter was under investigation by the Internal Revenue Service. In addition, the lender had stopped honoring checks drawn on the promoter's account to protect itself from losses. The proceeds from the loan to the sur-

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135 Klein v. First Edina Nat'l Bank, 196 N.W.2d 619 (Minn. 1972).

136 From a policy perspective, too, caution is advisable before attributing much significance to the length of a relationship. Consistent holdings along these lines would tend to discourage lenders from maintaining long-term relationships with their borrowers, or alternatively encourage them to reflect the additional risk in the cost of borrowing funds — results not justifiable by reference to any goal of fiduciary law.

137 *See* Dale v. Jennings, 107 So. 175, 179 (Fla. 1925); Hooper v. Barnett Bank, 474 So. 2d 1253, 1259 (Fla. Dist Ct. App. 1985); First Nat'l Bank v. Brown, 181 N.W.2d 178, 184 (Iowa 1970); Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 619 (Okla. Ct. App. 1982) (possibility of improper benefit justifies imposition of fiduciary duty). *But see* Atlantic Nat'l Bank v. Vest, 480 So.2d 1328, 1333 (Fla. Dist. Ct. App. 1985); Kurth v. Van Horn, 380 N.W.2d 693, 697 (Iowa 1986) (lender's use of plaintiff's co-signed loan to satisfy antecedent debt, thereby reducing lender's exposure to third party, held not improper); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619, 621 (Minn. 1972) (lender's use of loan proeeds to satisfy antecedent debt not improper).

138 474 So. 2d 1253 (Fla. Dist. Ct. App. 1985).

geon were deposited in the promoter's account, where they were available to cover the latter's checks. The court remarked that "the evidence [was] subject to a fair inference that the bank ultimately benefitted from this transaction."[139]

Similarly, in *First National Bank v. Brown*,[140] a borrower purchased a part interest in a filling station[141] with his loan proceeds. The lender, however, failed to disclose that it held a security interest in all of the station's business equipment. The owner of the station had begun to have trouble meeting his obligations to the lender, and most of the loan proceeds were applied immediately to reduce the seller's indebtedness to the lender.[142] The court noted that "[i]n other words, the bank dealt with defendants as tools with which to alleviate its own prior poor loan judgment. . . . Equity will not sanction such tactics."[143]

Notwithstanding the apparent unfairness of the lender's conduct in each of these cases, finding significance in the lender's obtaining some benefit in the transaction begs the question of a fiduciary relationship's existence. The benefit breaches no fiduciary duty until it is determined that the relationship is fiduciary. Thus, this factor is useless to determine the question whether a lender-borrower relationship has become fiduciary. Rather, it reflects, perhaps, the court's general sense that principles of fairness were violated.

Conversely, if the relationship has already been adjudged to be fiduciary — either conventional or unconventional — then it is proper to question whether the fiduciary has obtained a legitimate benefit. The question in such a case concerns the scope of the fiduciary duty arising from the relationship, however, and not with the existence of the relationship itself.

C. Determining the Scope of Fiduciary Duty

Once it is established that the lender-borrower relationship has become fiduciary, it must still be determined whether the lender's conduct breached the resulting duty of loyalty. Although in conventional fiduciary cases this step is the source of much of the ambiguity of fiduciary law, in unconventional cases,

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139 *Id.* at 1259.

140 181 N.W.2d 178 (Iowa 1970).

141 Apparently the purchase was never consummated, although the borrower's note was renewed several times. *Id.* at 180. The parties evidently treated the transaction as closed notwithstanding their failure formally to close it.

142 *Id.* at 181, 184.

143 *Id.* at 184.

it poses fewer difficulties than deciding whether the relationship is fiduciary. In lender cases, the duty of loyalty has two primary aspects: the duty to disclose, and the duty not to misuse confidential information.

1. The Duty to Disclose

The duty to disclose requires the lender to disclose information that the borrower would want to know, regardless whether the borrower requested disclosure or conducted an independent investigation.[144] Breach of this duty is variously described as "constructive fraud,"[145] "equitable fraud,"[146] or simply as the breach of a duty to speak.[147]

The cases are unclear as to whether the lender's duty to disclose is limited to material facts. Courts have not discussed the significance that information must have before non-disclosure breaches the duty. One court granted rescission of a sale contract based on non-disclosure of the identity of a member of the purchasing group[148] — a fact whose materiality is doubtful at best. The scope of the duty to disclose, however, should be limited to material facts, especially as breach of the duty may result in unenforceability of a contract that is untainted except by the alleged breach of duty. Undisclosed facts should be material before so harsh a remedy is imposed.

Facts that have been held to require disclosure include the lender's motivation in entering into the transaction,[149] the

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144 Brasher v. First Nat'l Bank, 168 So. 42, 45-46 (Ala. 1936); Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937); Camp v. First Fed. Sav. & Loan, 671 S.W.2d 213, 215-16 (Ark. Ct. App. 1984); Dale v. Jennings, 107 So. 175, 178 (Fla. 1925); Hooper v. Barnett Bank, 474 So. 2d 1253, 1258 (Fla. Dist Ct. App. 1985); Deist v. Wachholz, 678 P.2d 188, 193 (Mont. 1984). *But see* Kurth v. Van Horn, 380 N.W.2d 693, 697-98 (Iowa 1986) (duty to disclose requires evidence of affirmative misrepresentation); Denison State Bank v. Madeira, 640 P.2d 1235, 1243 (Kan. 1982) (duty to disclose exists only if the other party lacks the ability to ascertain the facts for itself).

145 Barrett v. Bank of Am., 229 Cal. Rptr. 16, 20 (Cal. Ct. App. 1986); *Deist*, 678 P.2d at 195 (constructive fraud is a "breach of duty without actual fraudulent intent," as to which the traditional elements of fraud are irrelevant).

146 First Nat'l Bank v. Brown, 181 N.W.2d 178, 181-82 (Iowa 1970); *see also Stewart*, 64 P.2d at 106 (duty to disclose intentions concerning future conduct).

147 Camp v. First Fed. Sav. & Loan, 671 S.W.2d 213, 215 (Ark. Ct. App. 1984); Dale v. Jennings, 107 So. 175, 178 (Fla. 1925); *see* Centerre Bank v. Distributors, Inc., 705 S.W.2d 42, 53 (Mo. Ct. App. 1985).

148 Deist v. Wachholz, 678 P.2d 188 (Mont. 1984).

149 For example, when the lender plans to use the loan to satisfy an antecedent debt of a third party — often after the pledge of collateral by the borrower, thus converting an unsecured, high-risk asset into a secured, low-risk asset — courts

lender's interest in an entity to be acquired with the borrowed funds,[150] the risks of the venture financed with borrowed funds[151] and the identity of the seller of property purchased with borrowed funds.[152] Finally, and unsurprisingly, affirmative false statements by a lender that has become a fiduciary of its borrower breach its duty to disclose.[153] All of this is quite consistent with fiduciary theory — as long as a fiduciary relationship has been properly established between the parties.

2. Misuse of Confidential Information

Fiduciary theory suggests that the fiduciary duty arising from the sharing of confidential information is narrower than that arising from giving business or financial advice. This is a consequence of the connection between the scope of the fiduciary duty and the scope of the power transferred to the fiduciary. That is, both the giving and acceptance of advice will often produce a more far-ranging control over the borrower's business "life" than will the fiduciary's acceptance of confidential information.[154] Sharing confidential information gives the lender the power only to misuse or misapply that information. The scope of the fiduciary duty arising from the sharing of confidential information is limited to the use of that information. Conduct unrelated to the information shared cannot be the basis for breach of fiduciary duty.

D. Substantive Fairness Revisited

The preceding analysis has focused for the most part on the

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have mandated disclosure. *See, e.g.*, Brasher v. First Nat'l Bank, 168 So. 42 (Ala. 1936); Hooper v. Barnett Bank, 474 So. 2d 1253 (Fla. Dist. Ct. App. 1985).

150 First Nat'l Bank v. Brown, 181 N.W.2d 178 (Iowa 1970).

151 Security Pac. Nat'l Bank v. Williams, 262 Cal. Rptr. 260 (Cal. Ct. App. 1989), *review denied, opinion withdrawn from publication*, 1989 Lexis 2309 (Cal. 1989).

152 Dale v. Jennings, 107 So. 175 (Fla. 1925).

153 Union State Bank v. Woell, 434 N.W.2d 712 (N.D. 1989) (finding breach of duty to disclose in lender's representation to auctioneer that property to be sold at auction was lender's collateral when in fact only some of the property was security for lender's debt). Some cases have implied that a quasi-fiduciary duty to disclose may arise even in the absence of any fiduciary relationship. *See, e.g.*, Richfield Bank & Trust Co. v. Sjogren, 244 N.W.2d 648 (Minn. 1976); *see* Camp v. First Fed. Sav. & Loan, 671 S.W.2d 213, 216 (Ark. Ct. App. 1984).

154 Advice given with respect to one area of the borrower's operation frequently affects other areas. For instance, a suggestion that purchases for inventory be reduced in favor of paying higher salaries to employees will affect inventory turnover ratios, inventory cost (to the extent that cost depends upon quantity purchased), employee morale and numerous other financial statistics and tangible and intangible factors.

deterrent goal of fiduciary law. Additionally, however, fiduciary law provides a means for substantive review of fiduciary-beneficiary agreements. Fiduciaries cannot hide behind notions of freedom of contract. The fiduciary mantle, once donned, sharply limits the ability of a fiduciary to contract with the beneficiary.

Although most common in conventional fiduciary relationships, where it passes largely unremarked, this second purpose of fiduciary law is also reflected in unconventional fiduciary cases. Here, it limits the ability of an unconventional fiduciary to enforce the terms of the original contract, and is potentially dangerous. The chief danger is that the terms of the commercial agreement between the ostensible fiduciary and the putative beneficiary will be reviewed prematurely, before the determination has been made that the relationship has in fact become fiduciary. Consequently, the review should be implemented the same way in conventional and unconventional fiduciary relationships. The determination that the relationship is fiduciary must be made before analyzing whether the resulting duties were breached.

Failure to observe the proper sequence of the issues has two consequences. First, contract law, whose principles for accomplishing the same result are ignored in the fiduciary analysis, is undermined.[155] Second, fiduciary law incorporates as precedent the cases' superficial analyses. It may be acceptable to permit a factfinder to determine that a breach of fiduciary duty has occurred, despite contract terms expressly permitting the conduct giving rise to the breach, when both parties were, or at least the fiduciary was, aware that the law limits the terms upon which the parties may agree. It is quite a different matter to permit the threshold question of the *existence* of a fiduciary relationship to turn on community notions of fairness in lending practices. When this happens, the real inquiry, namely the "fairness" of the terms of the agreement, is conducted covertly, behind the analytical smokescreen of the "nature of the relationship." If the relationship is deemed fiduciary, the agreement is rendered unenforceable, but in such a covert inquiry the *terms* of the agreement are nominally extraneous. Instead of interpreting the contract, the court purports to "interpret the relationship." The real

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[155] That is, fiduciary principles, and substantive review of contract terms, ought not to displace a conventional contract analysis until the determination is made that the relationship is fiducial. The role of courts in supervising contract relationships is different from, and less intrusive than, their role in supervising fiduciary relationships. *See* Frankel, *supra* note 3, at 825.

purpose, however, is to impose the court's view of what a "proper" contract should provide for the parties.

V. Conclusion

Fiduciary law is growing in importance as society moves toward increasing personal interdependence. Some of the analytical techniques that function acceptably for conventional fiduciary relationships do not serve their intended purposes when they are applied to unconventional fiduciary relationships. Understanding the foundation of the fiduciary doctrine is important to determine whether finding a fiduciary relationship is appropriate in a particular case.

The theory of power transferred to the fiduciary is useful in analyzing fiduciary cases. When it is applied to unconventional fiduciary cases, it becomes clear that courts should not resist making explicit the basis for their fiduciary analyses in unconventional cases; ambiguity serves a useful purpose only in conventional fiduciary cases. By emphasizing fiduciary power and the possibility of its abuse, and relating the elements of fiduciary theory to new instances of the fiduciary relationship, courts assist in the realization of fiduciary law's purposes and further the doctrine's emergence as a significant commercial principle.