A RESPONSE TO PROFESSOR LABY'S 'ADVISORS AS FIDUCIARIES': SYSTEMIC POWER, CRITICAL INTEREST, AND FIDUCIARY RELATIONSHIP

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Professor Arthur Laby's *Advisors as Fiduciaries* makes a significant contribution to our understanding of fiduciaries.[1] It should be required reading in this area of law. The dominant view of a fiduciary relationship is based on discretionary authority.[2] But this view, Professor Laby argues, is incomplete because the law consistently recognizes fiduciaries who are mere advisors without discretionary authority.[3] The insight here is as old as the scientific method: if a theory does not match confirmed observation, then the theory is either wrong or incomplete. Professor Laby seeks to complete our understanding of the theory of fiduciary relationships by arguing that "advisors are and should be considered fiduciaries based on the trust that advisors seek from their clients and the trust that clients repose in their advisors."[4] Relying on social science literature, he identifies the core elements of "advice."[5] The provision of advice begets a fiduciary relationship when it creates an expectation of trust, resulting in vulnerability.[6]

Several constellations comprise the universe of fiduciary relationships: (1) persons with discretionary authority; (2) status-based fiduciaries such as trustees, partners, directors, officers, and lawyers whose fiduciary capacity is fairly unquestioned by virtue of well-recognized status; and (3) ad hoc fiduciary advisors consistently recognized by case law.[7] The subject is interesting because perhaps the vast majority of all cases involve the explicit grant of discretionary authority or well-accepted status such that the existence of the fiduciary

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1. Arthur B. Laby, *Advisors as Fiduciaries*, 72 FLA. L. REV. 953 (2020).
2. *Id.* at 979–86.
3. *Id.* at 963–75 (providing various examples in the case law concerning business advisors, investment advisors, broker-dealers, doctors, and lawyers). *E.g.*, Burdett v. Miller, 957 F.2d 1375, 1381–82 (7th Cir. 1992) (holding that accountant advising on investment was a fiduciary though the accountant lacked discretionary authority over the client's assets).
4. Laby, *supra* note 1, at 997.
5. *Id.* at 1000–03 (citing various sources in social science literature).
6. *Id.* at 1001–08.
7. Discretionary authority is the power to exert decisional authority over the interest of another such as the designation of an agent with specific powers. *E.g.,* RESTATEMENT (THIRD) OF AGENCY § 2.01 (AM. L. INST. 2006) (stating agents can be given actual authority). Legal status grants such power as well. *E.g.,* DEL. CODE ANN. tit. 8, § 141(a) (2021) (granting the board of directors the power to manage the business and affairs of the corporation); UNIF. P'SHIP ACT § 401(h) (Nat'l Conf. of Comm'rs on Unif. State L. 1997) (amended 2013) ("Each partner has equal rights in the management and conduct of the partnership's business.").

relationship is clear and uncontested. If so, the remaining small fraction of cases dealing with ad hoc, fact-based rulings, where the fiduciary status is uncertain, may reveal the essential elements of a fiduciary relationship generally. Some commentators may have unnecessarily narrowed the concept of power to just a legal form. This conceptualization, I suspect, is driven by a hypothesis that fits most observations where fiduciary relationships are based on explicit grants of authority in contract or law. But case law exists that does not comfortably fit the hypothesis.[8] Professor Laby's concept focuses on the importance of advice, trust, and vulnerability.[9] This focus seems right, and his idea better explains the entire universe of fiduciary relationships. His analysis provides a better understanding of the full spectrum of fiduciary relationships.

This Response reformulates Professor Laby's insights with a focus on some additional considerations that should be in the analytical mix. With the edification of Professor Laby's analysis, this Response proposes that a person is a fiduciary when systemic power is exerted on a critical interest of another person. This concept accommodates both the discretionary authority view and Professor Laby's insight of advisors as fiduciaries even when such discretionary authority is lacking. Common elements exist in all fiduciary relationships. They are systemic power and critical interest.

Formal authority and legal status, granting discretionary authority, are not the only sources of power that are a condition to recognizing a fiduciary relationship. They are simply the clearest, strongest forms. Power in these situations derives from clear authority of some sort.[10] In this form, anyone with the capacity to undertake the duty can be a fiduciary, including family, friends, lawyers, accountants, or otherwise strangers. But power comes in other forms as well. Knowledge is power, either knowledge of a specialized field or information asymmetry.[11]

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8. *See Burdett*, 957 F.2d at 1381 ("But fiduciary duties are sometimes imposed on an ad hoc basis.").

9. Laby, *supra* note 1, at 999.

10. *E.g.*, Varity Corp. v. Howe, 516 U.S. 489, 504 (1996) ("[T]he primary function of the fiduciary duty is to constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime."). *See* Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975) ("First, the fiduciary must have scope for the exercise of discretion, and, second, this discretion must be capable of affecting the legal position of the principal."); Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 809 n.47 (1983) ("The term 'power' here means an ability to make changes that affect the entrustor.").

11. *See e.g.*, *Burdett*, 957 F.2d at 1381 (quoting Amendola v. Bayer, 907 F.2d 760, 763 (7th Cir. 1990)) ("We have emphasized knowledge and expertise but we do not mean to suggest that every expert is automatically a fiduciary. That is not the law in Illinois or anywhere else. A fiduciary relation arises only if 'one person has reposed trust and confidence in another who thereby gains influence and superiority over the other.'").

When advice is sought, there is trust, explaining the existence of vulnerability; when advice is needed, there is a disparity in knowledge, explaining the need for consultation.[12] Power is any trait of coercive influence, coercive in the sense of felt compulsion by the other. It can arise from any relationship when there is vulnerability.[13] Trust, vulnerability, and unequal standing in hierarchy or knowledge can enable a power structure in a relationship. In this form as well, anyone can potentially be a fiduciary. Thus, the first condition of a fiduciary relationship is the existence of power, often but not always in an authority-based form, that can be exerted against another.

"Power" in the general sense of the word often connotes a hierarchy. It is seen in all facets of society: *e.g.*, supervisor-subordinate, advisor-advisee, coach-player, parent-child, priest-parishioner, common carrier-customer, customer-business, business-supplier, teacher-student, tenured professor-untenured professor, etc. But a hierarchy is not a necessary condition of a structural power relationship. For example, advice can be freely discarded without consequence because a hierarchy may not exist between advisor and advisee; yet such advice can be coercive nevertheless. How should one sort these relationships to determine in a fact-based process whether a fiduciary relationship exists? Is there a common analytical framework that explains the full universe of fiduciary relationships? Unless constrained, the concept of power as an observation of any unique structure of a relationship is an unworkable, elastic concept. The only constraint on the expansion of fiduciary relationships would be an unmoored, ad hoc decision making by courts.

Fiduciary relationships are said to be "special," suggesting that they should not be commonplace.[14] Nor would one want courts to liberally recognize fiduciary relationships in a wide range of ordinary dealings in the personal and market spheres in light of the onerous burden of duty, high standard of conduct, and litigation of all matters of private dealings involving trust, vulnerability, and advice. With respect to fiduciary relationships arising from the grant of authority per contract or law, we are not concerned with potentially unlimited expansion because the grant of authority per contract or law, or lack thereof, is the limiting factor. But what limits the recognition of a fiduciary relationship whenever the fact of a power structure exists?

Professor Laby must answer the question of line-drawing. Relatively

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12. *See* Laby, *supra* note 1, at 1002.

13. *See* Laby, *supra* note 1, at 1006–08.

14. *See*, *e.g.*, Scheffler v. Adams & Reese, LLP, 950 So.2d 641, 648 (La. 2007) (describing a fiduciary relationship as a "special relationship of confidence or trust imposed by one in another who undertakes to act primarily for the benefit of the principal in a particular endeavor"); Brawn v. Oral Surgery Assocs., 819 A.2d 1014, 1026 (Me. 2003) (describing fiduciary relationship as a "special relationship").

few are fiduciaries, but in life we all give advice and exert influence ("power" in a general sense) per advice, trust, vulnerability, or hierarchy. "[W]hy is it that an automobile mechanic, who appears to provide diagnostic advice before making repairs, is not considered a fiduciary?"[15] Professor Laby answers this question with a three-factor test: "(1) how an advisor holds herself out; (2) an advisor's primary social, economic, or professional role; and (3) whether and how an advisor is compensated."[16] I am not entirely convinced that an advisor-centric analysis should wholly determine when "advice" gives rise to a fiduciary relationship. Consider this hypothetical: a famous "psychic to the stars" has a lucrative, exclusive "consultatory practice" in Beverly Hills, and the advice she gives a vulnerable actor is truly awful with tragic consequences on his wealth and personal life. Intuitively, it seems wrong to characterize this relationship as fiduciary even though the advice may be given in the context of high trust, asserted high specialty, high vulnerability, and high stakes.[17] An analytical framework must support the intuition that some relationships based on trust, vulnerability (or gullibility), and advice should not nevertheless beget a fiduciary relationship.

Certain predictable situations give rise to a systemic structure of a power relation, but most relations do not fall into this category. Commercial dealings between counterparties do not give rise to a fiduciary relationship.[18] Neither party has power over the other.[19] There may always be "power" in some general sense of that word, *e.g.*, "market power" or "bargaining power," but this is not the type of systemic power relation upon which, as a matter of policy, the law should impose a fiduciary relationship. Counterparties are said to deal at arm's length.[20] They are generally presumed to be of equal knowledge and vulnerability or to have the ability to achieve equal footing through negotiation, due diligence, and market mechanisms.[21] With respect to trust, counterparties understand that market ethics may cabin bad behavior, but maybe not, and thus they must be on guard. If extreme wrongdoing precludes this

15. Laby *supra* note 1, at 958.

16. *Id.* at 1015.

17. Under Professor Laby's standard, the most likely disqualifier of a fiduciary relationship in this example is that a psychic is not a "professional." Most rational persons would consider psychics to be charlatans. But his standard provides substantial flexibility to create some uncertainty.

18. John F. Mariani et al., *Understanding Fiduciary Duty*, 84 FLA. B.J. 21, 30 (2010).

19. Gregory S. Alexander, *Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 775 (1999).

20. *See* Jason W. Rigby, Note, *Financial Advisor Aiding and Abetting of a Breach of a Fiduciary Duty Post Rural Metro: Clarifying "Knowing Participation"*, 41 DEL. J. CORP. L. 545, 557 (2017) (discussing arms-length counterparties).

21. *See* Gregory S. Alexander, *Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 775 (1999).

potential for equal footing, the law may provide a remedy, such as an action for fraud.[22] Otherwise, the law presumes that market mechanisms such as price signals, reputation capital, and market intermediaries are adequate to mediate such relationships and transactions in the aggregate without the law's protection through a fiduciary relationship. One can easily see how the injection of law into these private affairs would distort behavior and impose significant costs for which the net benefit may not be so apparent.

These same general considerations explain why consultation on personal matters between friends or family, though obviously very important to the consultee, do not give rise to a fiduciary relationship.[23] Such persons stand at shoulder's length.[24] Presumed equal footing means that there are ready mechanisms to correct bad conduct or advice, such as reprobation, reputation, denial, and relationship severance. Here, again, the injection of law into these private affairs would be ill-advised. Sometimes, however, the assumption of equal footing and alternative mechanisms is questionable. For example, such assumptions may not be present in relationships containing structural vulnerabilities, such as those involving children or incapable persons. Law and policy must draw lines in such categories or circumstances.

A fiduciary relationship should not arise from giving advice in the contexts of commercial transactions, personal relationships, and most other kinds of social interactions even when (1) the advice is given by a trusted person, (2) a power relation, generally speaking, exists, and (3) the matter is subjectively important. In most instances when power is exerted, such power relation is unique to the circumstance and does not exist in a systemic, structural, predictable way. The presumption of equal footing and a reliance on other mechanisms to correct bad behavior or outcomes suffice without the law's interference into private affairs.

For power to be enabling, *i.e.*, to create a fiduciary relationship, it must be systemic. Systemic power means that the structure of a relationship as a class or category produces a consistent, predictable structure of power relation such that one cannot assume equal footing and arm's length dealing.[25] There are two facets of enabling power that limit its potential to expand the scope of fiduciary relationships into ordinary dealings. The first constraint is the quality of advisors. Professor Laby is correct that

22. *See generally* Mackenzie Dooner et al., *Securities Fraud*, 58 AM. CRIM. L. REV. 1431 (2021) (discussing key securities fraud provisions as a means of eliminating abuses in the marketplace).

23. *But see* Laby *supra* note 1 at 958 (suggesting that friends could be fiduciaries) (citing Ethan J. Leib, *Friends as Fiduciaries*, 86 WASH. U.L. REV. 665, 707–14 (2009)).

24. Gregory S. Alexander, *Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 774 (1999).

25. *See id.* at 775.

some qualities of the advisor limit when advice creates a fiduciary relationship. Most advisors found to be ad hoc, fact-based fiduciaries have special training or knowledge that is beyond ordinary knowledge and experience.[26] Special knowledge or training is systemic and structural in the sense that an obligee may need it, its application creates a structural form of trust and vulnerability, and monitoring through diligence or intermediaries to achieve equal footing is difficult. Special knowledge or training explains a class or category of advisers who have consistently been found to be fiduciaries, whether or not they have discretionary authority or status, including business advisors, lawyers, doctors, and accountants.

Again, power over another does not itself create a fiduciary relationship. A person may have power because the other is vulnerable, but there may be no fiduciary relationship, as seen with supervisors and subordinates, market counterparties, team captains and players, and sad adult personal relationships. Nor should trust or vulnerability beget a fiduciary relationship. There is a second constraint on the concept of power that limits the scope of a fiduciary relationship. Systemic power must be exerted on a critical interest.

Power and critical interest are not independent, but are linked. Power may not only derive from authority, hierarchy, trust, or vulnerability, but also from the existence of a critical interest. I say "critical" to suggest that the interest must be distinct from mere subjective importance. "Critical" could just as easily be a "protected" or "fundamental" interest, though these terms may cause confusion through their link to constitutional law. The law recognizes a critical interest as a class of interest that requires the protection of a fiduciary relationship.[27] Personal matters including financial issues, which may be honored or betrayed by another, are not critical interests. A spouse's trusted advice on matters of finance and wealth does not beget a fiduciary relationship despite a betrayal of trust and devastating financial consequences. Commercial dealings, which may be friendly or hostile between counterparties, are not critical interests. A business associate's foolish recommendation to acquire an asset does not beget fiduciary relationship. Trust, vulnerability, and importance of an interest—despite these elements being commonly identified in case law—are not enough.

Judgment calls must be made on the critical nature of the interest. Observations derive the rule. When money and wealth are handled in a systemic power relation, they are critical interests. As a matter of observation, society has drawn this line clearly and it needs little defense. This explains why fiduciaries include trustees, directors, officers,

26. *See* Laby, *supra* note 1 at 960, 1003.

27. D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1407 (2002).

partners, lawyers, bankers, investment advisors, and business advisors.[28] Few would contest these fiduciary designations as they are well established. There are other forms of critical interest, such as physical or mental well-being in the context of a formal stewardship setting and rights-based interests, which explain the imposition of fiduciary duty on doctors, lawyers, guardians, and parents.[29] With respect to these interests, the law has recognized them as subjects of protection under the fiduciary concept.

All fiduciary relationships, then, share common elements. A fiduciary relationship exists when systemic power is exerted over a critical interest. Enabling power is more than the simplest, clearest form of discretionary authority or legal status. Although advice, trust, vulnerability, hierarchy, knowledge, or information asymmetry—individually or collectively—can create a unique power relation, they are not enough to recognize a fiduciary relationship. Private affairs, in personal lives or business, can be a toxic brew of abuse, opportunism, and betrayal of confidence; our dealings in life can be imperfect, and those we deal with can disappoint. For the law to impose a fiduciary relationship and its special duties, systemic power must be applied to a critical interest. This determination distinguishes when trust, importance, and vulnerability would give rise to a fiduciary relationship and enabling power exists, and when coercive influence and vulnerability are simply facts of social and market reality.

In conclusion, Professor Laby's *Advisors as Fiduciaries* is a significant contribution to the literature on fiduciary relationship. All would learn from it. His attempt to explain a small but important segment of fiduciary relationships will be useful to practitioners, courts, and academics. Understanding that small segment may hold the key to a general theory of fiduciary relationship because courts find a duty based on facts and not simply grant of authority per contract or law. I agree with much of his analysis, particularly on the importance of advice, trust, and

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28. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders."); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director . . . the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation . . . , but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it . . . .").

29. *E.g.*, Hahn v. Mirda, 54 Cal. Rptr. 3d 527, 532 (Ct. App. 2007) (recognizing the doctor-patient fiduciary relationship); Johnson v. Cofer, 113 S.W.2d 963, 965 (Tex. App. 1938) (recognizing the attorney-client fiduciary relationship); Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992) (recognizing the guardian-ward fiduciary relationship); *see* Laby, *supra* note 1, at 958 (citing Elizabeth S. Scott & Robert E. Scott, *Parents as Fiduciaries*, 81 VA. L. REV. 2401, 2430–31 (1995)) (recognizing the parent-child fiduciary relationship); *see generally* Lionel Smith, *Parenthood is a Fiduciary Relationship*, 70 U. TORONTO L.J. 395 (2020).

vulnerability as being core elements in a fiduciary relationship, but there are additional considerations. This Response is an attempt to sort out the essence of a fiduciary relationship. In my view, a fiduciary relationship arises when systemic power creates a predictable structural relationship where arm's length dealing and equal footing cannot be assumed in certain classes or categories of relationships and that power is exerted against interests so critical that the law intrudes into private affairs through the imposition of a fiduciary relationship rather than relying on social and market mechanisms to deal with abuse and opportunism.