

## Advisors as Fiduciaries

Arthur B. Laby

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## ADVISORS AS FIDUCIARIES

*Arthur B. Laby*\*

### Abstract

This Article provides a sustained account of advice giving as a fiduciary activity, and it demonstrates that the dominant approach to defining fiduciary relationships is flawed. Leading academic commentators assert that fiduciary relationships only arise when one party has discretion over the assets or affairs of another. Yet, many advisors—such as lawyers, doctors, and investment professionals—lack discretion over a principal’s assets or affairs but are nonetheless considered fiduciaries by the courts. The dominant academic view of fiduciary relationships is therefore incomplete because it does not account for purely advisory relationships.

Drawing on interdisciplinary literature on trust and the normativity of advice, the Article demonstrates that imposing a fiduciary duty on certain advisors is not only consistent with contemporary judicial practice, but it is also normatively correct. In addition, the Article builds a framework for assessing which advisors should be subject to fiduciary responsibility. Not everyone who provides advice should be subject to fiduciary liability. Thus, the Article proposes factors to determine which advisors should be subject to fiduciary duties.

This Article addresses a matter of widespread importance. Most people rely on fiduciary advisors to aid with critical decision-making. Yet, the dominant academic approach would wrongly denude these advisors of fiduciary responsibility merely because they lack discretionary authority over their clients’ assets or affairs. This result would have adverse consequences for the advisory relationships on which most people rely.

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INTRODUCTION

Over the past forty years, legal scholars have attempted to capture the essence of the fiduciary relationship. Their approaches vary, but most appear to agree that fiduciary relationships arise when one party, the fiduciary, has discretion over the assets or affairs of another, the principal. The “discretionary authority” view of fiduciary relationships is pervasive in fiduciary scholarship and reflected in court decisions. Not surprisingly, many scholars also agree that the primary purpose underlying the fiduciary obligation is to guard against the fiduciary’s abuse of discretionary authority. Under this approach, fiduciary status arising from discretion is closely linked to an instrumental justification for fiduciary duties, namely deterring abuse.

The fiduciary obligation of professional advisors challenges the discretionary authority view. In many cases, advisors lack power or discretion over a principal's assets or affairs; yet advisors often are considered fiduciaries and subject to the fiduciary duties of loyalty and care. This Article examines advisors' fiduciary obligations and assesses the merits of the discretionary authority approach. The primary claim is that many advisors who lack discretion over their clients' assets or affairs are and should be considered fiduciaries and, therefore, the discretionary authority view of the fiduciary relationship is incomplete.

That advisors often are considered fiduciaries should not be controversial. Business advisors, investment advisors,<sup>1</sup> lawyers, physicians, and others are often deemed fiduciaries, although they lack discretionary authority. Recognizing that many advisors are fiduciaries has two implications for fiduciary theory, one regarding fiduciary status, the other regarding justification. First, the common claim that discretion is a necessary feature of all fiduciary relationships is erroneous. Many advisors lack discretion but are considered fiduciaries nonetheless. Second, the conventional justification for imposing fiduciary duties is inadequate. The conventional justification is that the fiduciary obligation serves to reduce the risk of abuse of discretionary authority and to diminish the chance that the fiduciary will misappropriate the principal's assets over which the fiduciary exercises power or control. When fiduciary relationships arise in the absence of discretionary authority, however, the need to control discretion is absent, and the conventional justification for imposing fiduciary duties is not applicable. As a result, a justification for imposing fiduciary duties that turns on controlling the fiduciary's discretion alone must be mistaken.

What then is the justification for placing a fiduciary duty on an advisor, who is not vested with discretionary authority? Drawing on literature on trust and the normativity of advice, I argue that the justification arises from the trust that advisors seek from their clients and the trust that clients repose in their advisors. Certain advisors assume a role that generates a relationship of trust and, as this Article explains, one can view the act of advising—in the words of Edward Hinchman—as an invitation to a client to repose trust in the advisor. Trust, however, also leads to a client's vulnerability and to reliance on an advisor, who is often

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1. There is an arcane debate over whether the term "advisor" should be spelled with an "e" or an "o." "Advisor" is more conventional, but Congress spelled the word with an "e" in the Investment Advisers Act of 1940 (IAA). *See* Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (2018). As a result, the U.S. Securities and Exchange Commission (SEC) and many securities lawyers use "adviser," not "advisor," although some securities lawyers use "advisor" for advisers regulated under the IAA and "advisor" for other advisors, such as broker-dealers, who provide advice but are not regulated under the IAA. For ease of reference and to avoid confusion, this Article follows the conventional spelling but recognizes the existence of both spellings in practice.

more expert and sophisticated than the client in the subject matter of the advice. The fiduciary duty for advisors grows out of the nature of the trust relationship, and it prevents the harm that can befall a vulnerable client when trust is misplaced. Although trust may not be an essential component of all fiduciary relationships, it is an essential component of advisory relationships, and it serves as the foundation for an advisor's fiduciary duty.

This Article fills an important gap in the literature on both advisors and fiduciary relationships. Although many advisors are considered fiduciaries, courts are split on advisors' fiduciary status.<sup>2</sup> Moreover, the provision of advice has bedeviled fiduciary law scholars, who recognize that advisory services do not fit well into standard accounts of fiduciary relationships.<sup>3</sup> A few scholars have examined the provision of advice in the context of fiduciary relationships.<sup>4</sup> This Article, however, is the first

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2. Compare *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992) (“[T]he relation between an investment advisor and the people he advises is not a [categorical fiduciary relationship].”), and *Edwards v. Mutter*, 18 CVS 2818, 2019 WL 6894511, at \*4 (N.C. Super. Ct. Dec. 17, 2019) (“North Carolina law has not recognized an investment advisor-client relationship as a *de jure* fiduciary relationship.”), with *SEC v. Capital Gains Res. Bureau, Inc.*, 375 U.S. 180, 191 (1963) (explaining that in passing the IAA, Congress recognized that advisors owe a fiduciary duty to clients), and *EBC I, Inc. v. Goldman, Sachs & Co.*, 832 N.E.2d 26, 31 (N.Y. 2005) (“A fiduciary relationship ‘exists . . . when one [party] is under a duty . . . to give advice for the benefit of another’” (quoting RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (AM. LAW INST. 1979))).

3. See, e.g., EVAN J. CRIDDLE & EVAN FOX-DECENT, *FIDUCIARIES OF HUMANITY* 332–33 (2016); Evan J. Criddle, *Liberty in Loyalty: A Republican Theory of Fiduciary Law*, 95 TEX. L. REV. 993, 1035–37 (2017); Paul B. Miller, *The Fiduciary Relationship*, in *PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW* 83–84 (Andrew S. Gold & Paul B. Miller eds., 2014); Lionel Smith, *Can We Be Obligated to Be Selfless?*, in *PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW*, *supra*, at 157 [hereinafter Smith, *Can We Be Obligated*]; Lionel Smith, *Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf of Another*, 130 LAW Q. REV. 608, 618 (2014) [hereinafter Smith, *Fiduciary Relationships*]; Julian Velasco, *Delimiting Fiduciary Status*, in *RESEARCH HANDBOOK ON FIDUCIARY LAW* 80–81, 87–90 (D. Gordon Smith & Andrew S. Gold eds., 2018).

4. See Andrew S. Gold, *Trust and Advice*, in *FIDUCIARIES AND TRUST* 35, 37–38 (Paul B. Miller & Matthew Harding eds., 2020) (analyzing trust and dependence in advisory fiduciary relationships); Andrew Tuch, *Investment Banks as Fiduciaries: Implications for Conflicts of Interest*, 29 MELB. U. L. REV. 478, 479 (2005) (examining whether the relationship between investment banks providing financial advisory services and their clients is fiduciary); Andrew Tuch, *Securities Underwriters in Public Capital Markets: The Existence, Parameters and Consequences of the Fiduciary Obligation to Avoid Conflicts*, 7 J. CORP. L. STUD. 51, 52 (2007) (“[I]t is the financial advisor dimension of the [underwriter-issuer] relationship that is key to the existence of fiduciary obligations.”); Andrew Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEX. L. REV. 1079, 1083 (2016) (arguing that mergers and acquisitions advisors “are properly characterized as fiduciaries of their clients”); Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1463 (2013) (arguing that underwriters and others should be subject to fiduciary duties when advising issuers regarding municipal bond

general sustained account of advice giving as a fiduciary activity including a justification for placing a fiduciary duty on advisors. Determining whether and when advisors are fiduciaries is fundamentally important to the conceptual structure of fiduciary law—and it is of great interest as a doctrinal and practical matter.

The stakes are high. As this Article explains, there are several reasons why fiduciary status is of utmost importance. Fiduciary law provides unique remedies when compared to professional negligence or professional malpractice. Fiduciary law encompasses a broader set of misconduct; the requirements to prove damages are eased; and a breach of fiduciary duty often carries more weight because it is viewed as more serious than professional negligence or malpractice.

This Article proceeds in three parts. To begin, Part I examines whether advisors that lack discretion over a principal's assets or affairs are considered fiduciaries and concludes that in many cases they are. Part I surveys several types of professional advisors to support this claim: business advisors, investment advisors, physicians, and lawyers. Furthermore, in some contexts, where courts typically are unwilling to impose fiduciary duties, advice giving turns the tables and leads courts to hold that a non-fiduciary relationship is in fact a fiduciary one. Part I of the Article explains and clarifies that advisors across various legal domains, who lack discretionary authority, are considered fiduciaries. Part I also sets the stage for a critique of the discretionary authority approach in Part II.

Next, Part II sets forth two implications of Part I for fiduciary theory. First, the discretionary authority approach, which generally holds that discretion is a necessary element of fiduciary relationships, is an incomplete theory of fiduciary duties because it cannot account for advisors as fiduciaries. Second, the common justification for imposing fiduciary duties—controlling fiduciary discretion—is similarly incomplete because advisors with no discretionary authority are considered fiduciaries nonetheless. Thus, there must be other reasons to impose fiduciary duties.

Finally, Part III considers why courts should impose a fiduciary duty on advisors. Part III describes and analyzes advisory relationships to determine how the law should treat such relationships. It argues that advisors often are and should be fiduciaries based on the trust that advisors seek from their clients. Part III begins by discussing the key

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offerings); William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 8 (2014) (analyzing banker-advisors as fiduciaries under agency principles); See generally Simone Degeling & Jessica Hudson, *Financial Robots as Instruments of Fiduciary Loyalty*, 40 SYDNEY L. REV. 63 (2018) (applying fiduciary duties to robo-advisors).

characteristics of advice and the role of trust in advisory relationships. It then explains that trust can lead to reliance and vulnerability on the part of the advisee with respect to matters that are the subject of the trust relationship. Part III explains that an advisor's fiduciary duty arises from the nature of the trust relationship. The fiduciary duties of loyalty and care prevent the harms that can result when such a relationship is abused, and they promote advisory relationships through ensuring that the advisor acts in the advisee's best interest.

Part III concludes with boundary considerations. At the end of Part III, I recognize that not all instances of advice giving necessarily lead to fiduciary liability. Imposing or attempting to impose fiduciary duties in all instances of advice giving would be impractical and overly legalistic. But the line drawing can be difficult. For example, why is it that an automobile mechanic, who appears to provide diagnostic advice before making repairs, is not considered a fiduciary? The Article proposes several considerations to help determine whether and when courts should impose fiduciary duties on certain advisors and not others. Not all forms of advice should be the subject of fiduciary liability.

Overall, the Article makes three contributions to the literature on fiduciary law and fiduciary theory. First, it clarifies, as a descriptive matter, that advisors in many contexts are considered fiduciaries. Second, it takes aim at the dominant discretionary authority approach to fiduciary relationships and demonstrates that discretion is not and should not be a necessary feature of such relationships. Third, it provides a sustained defense of advisors as fiduciaries based on trust. In that regard, the Article further develops the literature exploring in detail when certain members of society—voters,<sup>5</sup> politicians,<sup>6</sup> partners,<sup>7</sup> stockbrokers,<sup>8</sup> parents,<sup>9</sup> and even friends<sup>10</sup>—should be considered fiduciaries.

The themes in this Article are particularly timely. Fiduciary theory has exploded as a discipline over the past several years, with a growing number of workshops, conferences, books, and articles devoted to promoting a deeper understanding of fiduciary relationships and

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5. Edward B. Foley, *Voters as Fiduciaries*, 2015 U. CHI. LEGAL F. 153, 158, 181–82 (2015).

6. D. Theodore Rave, *Politicians as Fiduciaries*, 126 HARV. L. REV. 671, 706–11 (2013).

7. Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 237–46.

8. Donald C. Langevoort, *Brokers as Fiduciaries*, 71 U. PITT. L. REV. 439, 443, 446, 452 (2010); Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 730 (2012).

9. Elizabeth S. Scott & Robert E. Scott, *Parents as Fiduciaries*, 81 VA. L. REV. 2401, 2430–31 (1995); Lionel Smith, *Parenthood is a Fiduciary Relationship*, 70 U. TORONTO L.J. 395 (2020).

10. Ethan J. Leib, *Friends as Fiduciaries*, 86 WASH. U. L. REV. 665, 707–14 (2009).

fiduciary duties.<sup>11</sup> Fiduciary advice, however, has remained relatively unexplored in the academic literature. Moreover, federal and state regulators seek to determine whether and when to impose fiduciary duties on various professional advisors and what the scope of those duties should be.<sup>12</sup> The U.S. Securities and Exchange Commission (SEC) is split over the application of fiduciary duties to certain advisors.<sup>13</sup> Industry groups and trade associations are also engaged in a heated debate over when fiduciary duties arise for financial advisors.<sup>14</sup> A clear understanding of advisors as fiduciaries linked to a normative analysis of the essential features of fiduciary relationships is, therefore, more important than ever.

## I. FIDUCIARY ADVISORS

This Part considers whether, and under what circumstances, professional advisors are considered fiduciaries. According to the *Restatement (Second) of Torts*, one who gives advice for the benefit of

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11. See generally, e.g., FIDUCIARIES AND TRUST: ETHICS, POLITICS, ECONOMICS AND THE LAW (Paul B. Miller & Matthew Harding eds., 2020); CONTRACT, STATUS, AND FIDUCIARY LAW (Paul B. Miller & Andrew S. Gold eds., 2016); FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur Laby & Jacob Hale Russell eds., forthcoming); PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3; RESEARCH HANDBOOK ON FIDUCIARY LAW, *supra* note 3; THE OXFORD HANDBOOK OF FIDUCIARY LAW (Evan J. Criddle et al. eds., 2019).

12. See, e.g., NEV. REV. STAT. § 90.575 (2019); Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (July 12, 2019) (to be codified at 17 C.F.R. pt. 276); Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives, 51 N.J. Reg. 949(a) (proposed June 17, 2019), <https://www.njconsumeraffairs.gov/Proposals/Pages/bos-06172019-public-notice.aspx> [<https://perma.cc/FKX8-EY2A>].

13. See Public Statement of Robert J. Jackson, Jr., Comm'r, SEC Statement on Final Rules Governing Investment Advice (June 5, 2019), <https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd> [<https://perma.cc/PK4N-L5HM>].

14. See, e.g., Letter from David Certner, Legislative Counsel & Legislative Policy Dir., to The Hon. Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Aug. 7, 2018), <https://www.sec.gov/comments/s7-09-18/s70918-4184409-172588.pdf> [<https://perma.cc/LRJ8-GLDS>] (arguing for strengthening the fiduciary standard for investment advisors); Letter from Kevin R. Keller et al., Fin. Planning Coal., to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 7, 2018), <https://www.sec.gov/comments/s7-09-18/s70918-4185807-172700.pdf> [<https://perma.cc/3DKK-GVRM>] (criticizing the SEC proposal for investment advisor fiduciary duty as too weak); Letter from Kurt N. Schacht et al., CFA Inst., to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 7, 2018), <https://www.sec.gov/comments/s7-09-18/s70918-4184335-172561.pdf> [<https://perma.cc/3WDL-7P4M>] (arguing that interpretation of advisors' fiduciary duty may be too strong); Letter from Craig Pfeiffer, President & CEO, Money Mgmt. Inst., to Mr. Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 7, 2018), <https://www.sec.gov/comments/s7-07-18/s70718-4185314-172626.pdf> [<https://perma.cc/H2B3-FTS8>] (criticizing the SEC's broad interpretation as too imprecise).

another is a fiduciary.<sup>15</sup> This is a bold claim with enormous implications for individuals and firms that provide advice. The *Restatement*, however, neither explains nor supports the statement. The sole reference, a citation to the *Restatement (Second) of Trusts*, does not support the proposition that advisors are fiduciaries.<sup>16</sup> Moreover, the *Restatement's* claim is overbroad. As discussed later in Part III, not every advisor who provides advice for another's benefit is, or even should be considered, a fiduciary.

The question of whether advisors are fiduciaries has interested certain scholars for decades.<sup>17</sup> When a car mechanic advises a customer to undertake a repair, for example, the mechanic is not acting in a fiduciary capacity and would unlikely be liable for a breach of fiduciary duty based on the advice. Car mechanics, according to one court, are not normally considered fiduciaries although mechanics owe duties of honesty and care.<sup>18</sup> By contrast, when an investment advisor recommends that a client sell one security and buy another, the advisor often is considered a fiduciary and must act in the client's best interest.<sup>19</sup> Courts struggle to find guiding principles to explain why some advisors are considered fiduciaries and others not. As one court stated, "The trust and confidence that creates a fiduciary obligation is something more than the trust we necessarily place in [advisors] having superior knowledge . . . ."<sup>20</sup>

Before discussing whether advisors are fiduciaries, the Article briefly addresses the importance of fiduciary status. In other words, why should one care whether advisors are considered fiduciaries? After all, if an

15. RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (AM. LAW INST. 1979). The successor to *Restatement (Second) of Torts* § 874 does not repeat the claim that one who gives advice for the benefit of another is a fiduciary. See RESTATEMENT (THIRD) OF TORTS § 16 (AM. LAW INST. 2020). However, the *Restatement (Third)* contains an illustration to clarify that agreeing to provide expert advice can result in a fiduciary relationship. *Id.* illus. 4.

16. Surprisingly, the reference to the *Restatement (Second) of Trusts*, RESTATEMENT (SECOND) OF TRUSTS § 2 (AM. LAW INST. 1959), tends to undermine the conclusion that one who gives advice is a fiduciary. The *Restatement (Second) of Trusts* distinguishes between confidential and fiduciary relationships and states that a "confidential relation exists between two persons when one has gained the confidence of the other and purports to . . . advise with the other's interest in mind." *Id.* cmt. b (emphasis added). Thus, according to the *Restatement (Second) of Trusts*, an advisory relationship is a confidential relationship but not necessarily a fiduciary one. *Id.* The *Restatement (Second) of Trusts* is careful to say that a confidential relationship is not a fiduciary relationship. *Id.* The *Restatement (Second) of Trusts* draws this statement from the *Restatement (First) of Trusts*. RESTATEMENT (FIRST) OF TRUSTS § 2 cmt. b (AM. LAW INST. 1935). The *Restatement (First)*, however, provides no additional explanation. *Id.*

17. See P.D. Finn, *The Fiduciary Principle*, in EQUITY, FIDUCIARIES AND TRUSTS 49 (T.G. Youdan ed., 1989) (explaining that the possible fiduciary status of advisors is "the most significant controversy" in fiduciary law).

18. *Int'l Ins. Co. v. Certain Underwriters at Lloyd's London*, No. 88 C 9838, 1991 WL 349914, at \*9 (N.D. Ill. Sept. 16, 1991).

19. See *infra* Section I.B.2.

20. *Int'l Ins. Co.*, 1991 WL 349914, at \*9.

advisor can be liable for professional negligence or professional malpractice, whether the advisor is a fiduciary may be irrelevant.

### A. *The Importance of Fiduciary Status*

Before discussing whether advisors are fiduciaries, one might ask whether fiduciary status has any practical importance, particularly if a client can sue for professional malpractice based on a violation of the relevant standard of care. Courts often dismiss a breach of fiduciary duty claim as duplicative when based on the same operative facts as a claim for professional negligence or professional malpractice.<sup>21</sup> In the health care context, courts often rely on negligence rather than fiduciary duty when awarding damages.<sup>22</sup>

There are several reasons why fiduciary status is important. First, although there is overlap between fiduciary law and professional negligence, fiduciary law provides plaintiffs with a separate cause of action that has a different focus and distinct remedies.<sup>23</sup> Allegations of breach of fiduciary duty often target dishonesty, unfaithful service, conflicts of interest, and self-dealing.<sup>24</sup> By contrast, allegations of professional negligence target a breach of the duty of care.<sup>25</sup>

Second, the elements to support a breach of fiduciary duty claim are not the same as the elements to support a professional malpractice claim. To demonstrate a breach of fiduciary duty, for example, a plaintiff can prove either injury to the plaintiff or a benefit to the defendant.<sup>26</sup> To demonstrate professional negligence, however, the plaintiff must prove actual damages to the plaintiff.<sup>27</sup> The absence of a requirement to prove

21. *Neade v. Portes*, 739 N.E.2d 496, 500–03 (Ill. 2000) (explaining how a breach of fiduciary duty claim can be duplicative of a medical malpractice claim); *Majumdar v. Lurie*, 653 N.E.2d 915, 920–21 (Ill. App. Ct. 1995) (“When, as in this case, the same operative facts support actions for legal malpractice and breach of fiduciary resulting in the same injury to the client, the actions are identical and the later [sic] should be dismissed as duplicative.”); *Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*, 780 N.Y.S.2d 593, 596 (App. Div. 2004) (stating that breach of fiduciary duty claims that are premised on the same facts and seeking identical relief sought in legal malpractice claims are “redundant and should be dismissed”).

22. *Thomas L. Hafemeister & Selina Spinos, Lean on Me: A Physician’s Fiduciary Duty to Disclose an Emergent Medical Risk to the Patient*, 86 WASH. U. L. REV. 1167, 1202 (2009); see also *Pegram v. Herdrich*, 530 U.S. 211, 230–32, 234–37 (2000) (finding that medical malpractice does not give rise to a fiduciary breach under ERISA).

23. See *Hafemeister & Spinos*, *supra* note 22, at 1200.

24. See *Metrick v. Chatz*, 639 N.E.2d 198, 203 (Ill. App. Ct. 1994).

25. 7A C.J.S. *Attorney & Client* § 304 (2020).

26. *Jones v. Blume*, 196 S.W.3d 440, 447 (Tex. App. 2006). Although many courts and commentators state that an element is injury to the plaintiff, it is generally sufficient to show benefit to the defendant.

27. *Budd v. Nixen*, 491 P.2d 433, 436 (Cal. 1971), *superseded by statute*, CAL. CIV. PROC. CODE § 340.6(a)(1) (West 1995), *as recognized in Adams v. Paul*, 904 P.2d 1205 (Cal. 1995);

damages provides a possible breach of fiduciary duty claim where a negligence claim would be unavailable.

Third, a breach of fiduciary duty can encompass a broader scope of misconduct than professional negligence. Breach of fiduciary duty can apply when a professional has a duty to disclose a risk even if the professional is not the source of the risk; professional negligence is limited to situations where the professional causes the risk.<sup>28</sup>

Fourth, a breach of fiduciary duty is often viewed as more serious than professional negligence. Not all instances of professional negligence amount to a breach of fiduciary duty.<sup>29</sup> There are categories of misconduct that are simply not viewed as serious enough to give rise to fiduciary liability. The whiff of serious misconduct conveyed by articulating a breach of fiduciary duty is another reason a plaintiff may wish to claim that an advisor is a fiduciary.<sup>30</sup>

Fifth, fiduciary status is important for the available remedies. Remedies for a breach of fiduciary duty are both stronger and more flexible than remedies for other actions, such as professional negligence. Fiduciary remedies combine relief typically available in contract, tort, and equity.<sup>31</sup> They include remedies to stop future violations, not only to remedy past ones.<sup>32</sup> Moreover, just as a plaintiff does not have to show injury to bring a fiduciary duty claim, fiduciary remedies are available even when the principal is unharmed, and the fiduciary has acted in good faith.<sup>33</sup>

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MC Baldwin Fin. Co. v. DiMaggio, Rosario & Veraja, LLC, 845 N.E.2d 22, 30 (Ill. App. Ct. 2006); Rudolf v. Shayne, Dachs, Stanisci, Corker & Sauer, 867 N.E.2d 385, 387 (N.Y. 2007).

28. An example is a requirement to disclose emergent medical risks—adverse medical conditions that the physician either causes or discovers in the course of medical treatment, of which the patient is unaware, and which could result in harm if not disclosed. Hafemeister & Spinos, *supra* note 22, at 1170. There is a difference between a physician who causes an emergent medical risk and fails to disclose it, and a physician who discovers an emergent medical risk caused by another, or inherent in a patient, and fails to disclose it. *See id.* at 1203. Only the former—when the doctor causes the risk—will likely give rise to a medical malpractice claim. *Id.* Breach of fiduciary duty, however, could cover both scenarios. *Id.*

29. *Metrick*, 639 N.E.2d at 203; *see also* 7A C.J.S. *Attorney & Client*, *supra* note 25, § 304 (discussing when an attorney can waive a right of the client without breaching his fiduciary duty).

30. *See Metrick*, 639 N.E.2d at 203.

31. TAMAR FRANKEL, *FIDUCIARY LAW* 248 (2011).

32. *Id.*

33. *See* Joshua Getzler, *Ascribing and Limiting Fiduciary Obligations: Understanding the Operation of Consent*, in *PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW*, *supra* note 3, at 41 (“The policy of nullification or prophylaxis is so crucial that even where no harm to beneficiary interests is demonstrated and even where good faith is shown, the full gamut of remedies may be applied to ensure that there is no taint affecting the fiduciary’s conduct.”). A standard remedy for a breach of fiduciary duty is disgorgement of ill-gotten gains. A court may order disgorgement regardless of whether the principal has suffered a loss or the fiduciary has engaged in willful misconduct. Paul B. Miller, *Justifying Fiduciary Remedies*, 63 U. TORONTO L.J. 570, 571 (2013)

A final reason fiduciary status is important is for the availability of certain legal theories in actions brought by third parties or regulators, and not necessarily by the advice recipient. An example is insider trading liability. Under the classical theory of insider trading, a duty to disclose or abstain from trading arises when one party has information that another is entitled to know because of a fiduciary relationship, or a similar relationship of trust and confidence.<sup>34</sup> Under the misappropriation theory of insider trading, a person can be liable under the securities laws when she misappropriates confidential information for trading in breach of a fiduciary duty owed to the source of the information.<sup>35</sup> Thus, liability for insider trading often depends on fiduciary status.<sup>36</sup>

When an advisor provides unsound, improper, or conflicted advice, there may be several reasons to pursue a claim for breach of fiduciary duty as opposed to a claim for professional liability. Thus, the next step is to determine whether advisors are fiduciaries, particularly when they lack discretion over a client's assets or affairs.

### B. *Advisors as Fiduciaries*

Many advisors are considered fiduciaries although they lack discretionary authority over their advisory clients. To be clear, in some cases, advisors can and do assume discretionary power. When they do, courts often find a fiduciary relationship based on that authority. My focus, however, is on advisors who lack discretion. As discussed in more detail below, by discretion this Article invokes the definition of the term generally used by writers in the fiduciary field. Discretion represents

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("[G]ain-based remedies are particularly remarkable in the fiduciary context because they are available almost without limitation. They may be awarded whether or not the beneficiary suffered a material set-back to interests or whether the fiduciary showed wilful intent to appropriate the gain."). Courts can even order disgorgement when a principal has *gained* as a result of a fiduciary breach; the fiduciary will still be required to relinquish the fiduciary's profits. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 888 ("Even if the fiduciary's actions have not injured the beneficiary, and even if the beneficiary has in some sense gained as a result of the fiduciary's act, the fiduciary must account to the beneficiary for its profits.").

34. See *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

35. See *United States v. O'Hagan*, 521 U.S. 642, 650–52 (1997).

36. The importance of one's status as a fiduciary in the insider trading context is borne out in caselaw. A psychiatrist, for example, owes a fiduciary duty to a patient. Thus, when a doctor traded based on information he received from a patient, he did so in breach of a duty owed to the patient and was liable as a result. See *SEC v. Willis*, 825 F. Supp. 617, 619 (S.D.N.Y. 1993). By contrast, members of an exclusive club, the Young Presidents Club, did not owe a fiduciary duty to one another although club members regularly sought advice from one another. *United States v. Kim*, 184 F. Supp. 2d 1006, 1013 (N.D. Cal. 2002). As a result, trading by one member based on information he received from another could not support an insider trading violation. See *id.*

legal power over the significant practical interests of another.<sup>37</sup> To demonstrate that advisors shorn of discretionary authority are often considered fiduciaries, this Section focuses on five cases: business advisors, investment advisors, stockbrokers, physicians, and attorneys. These professionals, as a descriptive matter, are often deemed fiduciaries in cases where they lack a discretionary mandate. After surveying these five examples, the Article briefly discusses the importance of advice in determining fiduciary status—providing advice is often the key consideration that transforms a person not normally considered a fiduciary into a fiduciary.

### 1. Business Advisors

Banks and other business advisors provide business advice to individuals and firms in need of their expertise.<sup>38</sup> A bank does not normally owe a fiduciary duty to a bank customer; the debtor–creditor relationship typically is not fiduciary.<sup>39</sup> A bank, however, may owe a fiduciary duty to a customer when special circumstances exist. One of the “special circumstances” is when a customer receives and relies on the lender’s advice.<sup>40</sup> When banks serve as business advisors, the relationship is often considered fiduciary, although the bank has no discretion over the customer’s funds or business affairs.<sup>41</sup>

Consider a pair of cases where banks provided business advice tainted by a conflict of interest. The first is *Buxcel v. First Fidelity Bank*.<sup>42</sup> In that case, the Buxcels were looking to buy a business.<sup>43</sup> First Fidelity advised them to purchase a grocery store from the Fabers, who were also First Fidelity customers.<sup>44</sup> The Buxcels purchased the store, pledging their

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37. See, e.g., Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1046–48 (1991); Miller, *supra* note 3, at 69; D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1449 (2002).

38. See Laura Lin, *The Information Content of a Bank’s Involvement in Private Workouts*, 3 GEO. MASON INDEP. L. REV. 97, 108 (1994).

39. *United Jersey Bank v. Kensey*, 704 A.2d 38, 44 (N.J. Super. Ct. App. Div. 1997) (“The virtually unanimous rule is that creditor-debtor relationships rarely give rise to a fiduciary duty.”); see also *Buxcel v. First Fid. Bank*, 601 N.W.2d 593, 603 (S.D. 1999) (Konenkamp, J., dissenting) (“In ordinary lender-borrower relations, therefore, no fiduciary duty exists.”).

40. See Cecil J. Hunt, II, *The Price of Trust: An Examination of Fiduciary Duty and the Lender-Borrower Relationship*, 29 WAKE FOREST L. REV. 719, 740–41, 768 (1994). The other “special circumstances” are when the borrower reposes trust and confidence in the lender, and when the borrower dominates or controls the borrower. *Id.* at 740–41.

41. *Id.* at 741.

42. 601 N.W.2d 593 (S.D. 1999).

43. *Id.* at 594.

44. *Id.* at 595.

farm and home as collateral.<sup>45</sup> First Fidelity financed the purchase and advised the Buxcels to obtain a Small Business Administration (SBA) guaranteed loan, which allowed the bank to reduce its risk.<sup>46</sup>

After the store failed, the Buxcels learned that the Fabers were heavily indebted to First Fidelity.<sup>47</sup> Moreover, First Fidelity wanted the Fabers to sell the business so the bank could avoid foreclosing on the loan.<sup>48</sup> The bank's advice to the Buxcels, therefore, was tainted with a conflict of interest. The Buxcels sued the bank alleging breach of fiduciary duty and other claims.<sup>49</sup> The South Dakota Supreme Court reversed the lower court and held that special circumstances existed to create a fiduciary duty by the bank to disclose the grocery store's negative history.<sup>50</sup> In *Buxcel*, the bank acted merely as an advisor. It had no discretion over the Buxcels' assets or affairs. Nevertheless, the court concluded that the bank had a fiduciary duty to disclose its conflict.<sup>51</sup>

Similarly, in *Morris v. Resolution Trust Corp.*,<sup>52</sup> the provision of business advice shorn of discretionary authority gave rise to a fiduciary relationship.<sup>53</sup> There, Baychar Morris hired Steven Wood to renovate Morris's building.<sup>54</sup> Part of the way through the work, Wood told Morris that the project would be more expensive than anticipated, and Wood advised Morris to seek financing from American Bank.<sup>55</sup> Morris met with American Bank's Jonathan Young and sought Young's advice about continuing to use Wood for the job, questioning Young about Wood's ability and integrity.<sup>56</sup> Young told Morris that she need not worry about Wood and she should not consider alternative contractors.<sup>57</sup> Young further advised Morris to pay Wood using Morris's personal funds and reimburse herself with a loan from American Bank.<sup>58</sup> Young did not disclose that Wood was delinquent on debts owed to American Bank, thereby creating a conflict of interest for the bank.<sup>59</sup> The bank would be more likely to collect from Wood once Wood was paid by Morris.<sup>60</sup>

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45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 594.

50. *Id.* at 597–99.

51. *Id.* at 596.

52. 622 A.2d 708 (Me. 1993).

53. *Id.* at 712.

54. *Id.* at 710.

55. *Id.*

56. *Id.*

57. *Id.* at 711.

58. *Id.*

59. *Id.*

60. *See id.*

Morris sued American Bank for breach of fiduciary duty, and the bank counterclaimed for amounts due on Morris's loan.<sup>61</sup> A jury decided for Morris on the breach of fiduciary duty claim.<sup>62</sup> The Maine Supreme Judicial Court held that the jury could have found a fiduciary relationship based on trust and confidence and the disparity of position and influence between the parties.<sup>63</sup> Moreover, the court appeared to recognize that Young did not exercise control over Morris. The court rejected the argument that to find a fiduciary relationship, the principal must be incapable of protecting her own interests.<sup>64</sup> Thus, business advisors, such as First Fidelity and American Bank, can be subject to fiduciary duties although they lack control over the customer's assets or affairs.

## 2. Investment Advisors

Investment advisors are often considered fiduciaries regardless of whether they exercise discretionary authority over client assets. Investment advisors are regulated under federal statutes and the common law.<sup>65</sup> The Investment Advisers Act of 1940 (IAA)<sup>66</sup> defines an investment advisor as a person or a firm that is in the business of providing advice about securities for compensation.<sup>67</sup> Some advisors exercise discretion over client assets; others do not.<sup>68</sup> Advisors registered with the SEC must indicate whether they have discretion over client funds, and the amount of their assets under management for which they have discretionary authority.<sup>69</sup> All investment advisors regulated under the IAA, even those without discretion, owe a fiduciary duty to clients and potential clients.<sup>70</sup> Federal law does not exempt nondiscretionary advisory accounts from the fiduciary obligation.

61. *Id.*

62. *Id.* The RTC, which assumed receivership of American Bank, challenged the jury's finding that the bank breached its fiduciary duty. *Id.* at 711–12.

63. *Id.* at 712.

64. *Id.*

65. *See* Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (2018). Other statutes, *e.g.*, Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 832 (codified as amended at 29 U.S.C. § 1001 (2018)), can apply to advisors in certain circumstances.

66. Ch. 686, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1 to 80b-21).

67. Investment Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

68. An advisor exercises discretion if the advisor is authorized to determine which securities to buy or sell for an account or if the advisor makes decisions about what securities to buy or sell. Securities Exchange Act of 1934 § 3(a)(35), 15 U.S.C. § 78c(a)(35) (2018).

69. *See* 17 C.F.R. § 279.1 (2019); *Form ADV (Paper Version)*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/about/forms/formadv-part1a.pdf> [<https://perma.cc/22JU-2L2X>].

70. *See, e.g.*, *United States v. Lay*, 566 F. Supp. 2d 652, 656 (N.D. Ohio 2008) (“SEC registered investment advisers, and their officers and directors, have a fiduciary duty to their

The leading case is *SEC v. Capital Gains Research Bureau, Inc.*<sup>71</sup> In *Capital Gains*, the U.S. Supreme Court reviewed an SEC enforcement action against an advisory firm, which published investment newsletters, for a practice known as scalping.<sup>72</sup> Scalping occurs when an advisor buys a security for its own account, recommends that clients purchase the same security, then sells the security at a profit without disclosing the firm's interest.<sup>73</sup> In *Capital Gains*, the firm had no discretionary authority. In fact, clients did not open advisory accounts with the firm; they subscribed to a newsletter.<sup>74</sup> Furthermore, there was no evidence that clients ever purchased shares of the recommended securities.<sup>75</sup> Indeed, the firm did not even know whether any subscriber followed its recommendations.<sup>76</sup> As a result, the firm was not vested with discretion.

The Court held that the advisor's conduct was a breach of fiduciary duty and a violation of the IAA's antifraud provision.<sup>77</sup> In language that has become the axiom of professional investment managers, the Court stated that advisors must adhere to a duty of "utmost" good faith, a duty of full and fair disclosure of all material facts, and an obligation to use reasonable care to avoid misleading clients.<sup>78</sup> Over fifty years later, the SEC, securities lawyers, and investment professionals still look to *Capital Gains* for the standard articulation of an investment advisor's fiduciary duty, regardless of whether the advisor has discretion over investor funds.<sup>79</sup> One might be tempted to dismiss the investment advisor

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clients, which includes acting in good faith in the best interest of the client, making full and fair disclosure of material facts regarding the investment relationship, and employing reasonable care to avoid misleading the client."), *aff'd*, 612 F.3d 440 (6th Cir. 2010).

71. 375 U.S. 180 (1963) (holding that the IAA prohibits scalping).

72. *Id.* at 181–83.

73. See *SEC v. Park*, 99 F. Supp. 2d 889, 892 (N.D. Ill. 2000) (defining scalping).

74. See Affidavit of Harry P. Schwarzmann at 26–27, *Capital Gains*, 375 U.S. 180 (No. 618); *Capital Gains*, 375 U.S. at 182–83.

75. *SEC v. Capital Gains Research Bureau, Inc.*, 300 F.2d 745, 748 (2d Cir. 1961), *reh'g granted*, 306 F.3d 606 (2d Cir. 1962), *rev'd*, 375 U.S. 180 (1963).

76. Brief for Respondents at 6, *Capital Gains*, 375 U.S. 180 (No. 42), 1963 WL 105899, at \*6.

77. *Capital Gains*, 375 U.S. at 201 ("The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients.").

78. *Id.* at 194 (describing fiduciary duty).

79. See, e.g., *SEC v. DiBella*, 587 F.3d 553, 567–68 (2d Cir. 2009); *SEC v. Levine*, 671 F. Supp. 2d 14, 27 (D.D.C. 2009); Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41,018, 41,021–22 (July 14, 2010); Jennifer S. Taub, *Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. CORP. L. 843, 856–57 (2009). That advisors owe a fiduciary duty to potential clients as well as clients is another reason demonstrating that advisors are fiduciaries even when they lack discretion. The IAA's antifraud provision, and by implication the advisor's fiduciary obligation, apply to both clients and potential

example as a unique obligation imposed by Congress. Neither the IAA nor the *Capital Gains* case, however, imposed a fiduciary duty on advisors. Congress and the Court merely recognized advisors' preexisting common law fiduciary duty, which applies to clients and potential clients regardless of the advisor's discretionary authority over client funds.<sup>80</sup>

### 3. Broker-Dealers

The case of broker-dealers is more complex than that of investment advisors. Brokers perform different functions than investment advisors, and they are subject to different regulation, although they too often provide investment advice to customers.<sup>81</sup> The general rule, consistent with the discretionary authority approach, is that when a brokerage account is discretionary, the broker is considered a fiduciary; however, when the account is nondiscretionary, the broker is held to a standard of suitability—a duty to ensure that the recommended securities are suitable for the particular customer.<sup>82</sup> Notwithstanding the general rule, the law is

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clients. Investment Advisers Act § 206, 15 U.S.C. § 80b-6 (2018). In the case of a potential client, the advisor by definition lacks discretion. The relationship is preliminary; no final decision has been made regarding whether an advisory relationship will form. Yet, even at this stage, an advisor owes a fiduciary obligation to these potential clients. *See* SEC v. Bolla, 401 F. Supp. 2d 43, 71 (D.D.C. 2005), *aff'd in part sub nom.* SEC v. Wash. Inv. Network, 475 F.3d 392 (D.C. Cir. 2007).

80. *See* Arthur B. Laby, SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940, 91 B.U. L. REV. 1051, 1085–86 (2011). Similarly, ERISA defines a fiduciary with respect to a plan as anyone who exercises discretionary authority over the management of a plan or plan assets, or anyone who renders advice for compensation with respect to money or other property of a plan. Employee Retirement Income Security Act of 1974 (ERISA) § 3(21)(A), 29 U.S.C. § 1002(21)(A) (2018); *see also* Definition of “Fiduciary,” 29 C.F.R. § 2510.3-21(c) (2019) (clarifying that advice under ERISA includes nondiscretionary advice). One might be tempted to dismiss the ERISA example as a unique statutory scheme. But like in the case of the IAA, ERISA fiduciary law is based on the common law of trusts. H.R. REP. NO. 93-533 (1973), *as reprinted in* 1974 U.S.C.C.A.N. 4639, 4649 (“The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts.”); *see also* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989) (citing H.R. REP. NO. 93-533 with approval).

81. Broker-dealers are regulated by the Securities Exchange Act of 1934. *See* ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78qq (2018)). Although many brokers also meet the definition of investment advisor discussed above, the definition contains an exclusion for broker-dealers as long as their advice is incidental to brokerage services, and they receive no special compensation for providing advice. *See* Investment Advisers Act § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C) (2018); *see also* Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 BUS. LAW. 395, 403–05, 412–21 (2010) (detailing and analyzing the broker-dealer exclusion).

82. *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 719 (2010); *id.* at 723 (“Most courts, looking to state law for guidance, conclude that only brokers for discretionary, as opposed to non-discretionary, accounts are considered fiduciaries.”). In 2019, the SEC revised the broker-dealer standard of conduct with respect to retail customers and imposed a “best interest” obligation on brokers. *See* Regulation

more nuanced when a special relationship develops between a broker and a customer, and courts hold that, absent discretion, brokers who provide advice can be fiduciaries.

Consider two examples. First, in *MidAmerica Federal Savings & Loan Ass'n v. Shearson/American Express Inc.*,<sup>83</sup> MidAmerica established a money market fund and needed to reinvest certain assets for short periods.<sup>84</sup> MidAmerica spoke to Don Crow, a Shearson representative, who recommended that MidAmerica purchase certain GNMA unit trusts that Crow said would perform like other GNMA securities.<sup>85</sup> GNMA unit trusts, however, were designed for small investors to buy and hold, and they carried an additional sales charge, making them unsuitable for short-term investment.<sup>86</sup> When Shearson would not agree to rescind MidAmerica's purchases, MidAmerica sued for breach of fiduciary duty and other violations.<sup>87</sup> The court stated that although MidAmerica's account was nondiscretionary, which would normally preclude the existence of a fiduciary relationship, that fact would not defeat MidAmerica's fiduciary claim.<sup>88</sup> Shearson was in a position of strength, and MidAmerica relied on Crow's misrepresentations.<sup>89</sup> As a result, the court found sufficient evidence to support the jury's decision that a fiduciary relationship existed and that Crow breached his fiduciary duties.<sup>90</sup>

Similarly, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*,<sup>91</sup> the court clarified that a fiduciary relationship can arise in the context of a nondiscretionary brokerage account.<sup>92</sup> William Grace, a Merrill Lynch representative, agreed to act as the Chengs' broker with respect to a nondiscretionary account.<sup>93</sup> The Chengs alleged that after Grace assisted them for a year, he engaged in a series of unauthorized transactions.<sup>94</sup> The Chengs claimed that they had a fiduciary relationship with Merrill Lynch based on the trust and confidence they placed in Grace and on his

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Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,328 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240).

83. 886 F.2d 1249 (10th Cir. 1989).

84. *Id.* at 1251.

85. *Id.* at 1251–52.

86. *Id.* at 1252.

87. *Id.* at 1253.

88. *Id.* at 1258.

89. *Id.*

90. *Id.*

91. 697 F. Supp. 1224 (D.D.C. 1988).

92. *Id.* at 1226–27.

93. *Id.* at 1225.

94. *Id.*

agreement not to trade without approval.<sup>95</sup> Merrill Lynch argued that a fiduciary relationship cannot arise when an account is nondiscretionary.<sup>96</sup> The court, however, sided with the Chengs and upheld a fiduciary relationship.<sup>97</sup> Thus, even when a customer opens a nondiscretionary brokerage account, the relationship can be fiduciary—setting aside the general rule that brokers to nondiscretionary accounts are not fiduciaries.

#### 4. Physicians

When providing patient care, physicians in some circumstances can have discretionary authority over a patient's treatment. Surgeons, for example, must occasionally make intraoperative decisions with no opportunity to consult the patient or the patient's close relatives.<sup>98</sup> In rarer cases, physicians have authority over a patient's decision to forgo life-sustaining treatment.<sup>99</sup> Physicians also can act in an advisory capacity where they lack discretionary authority, leaving medical decisions in the patient's hands after full disclosure of treatment options and the attendant risks.<sup>100</sup> Where physicians act as advisors without discretion over patient care, as demonstrated below, courts often impose a fiduciary obligation to define physicians' duties. Imposition of a fiduciary obligation in these cases is consistent with the general principle that physicians are fiduciaries.<sup>101</sup> A physician's fiduciary obligation includes a duty to disclose information about a patient's care, disclose conflicts of interest about a physician's compensation, and maintain confidential information.<sup>102</sup>

95. *Id.* at 1226.

96. *Id.*

97. *Id.* at 1226–27.

98. See Rhona Flin et al., *How Do Surgeons Make Intraoperative Decisions?*, 16 QUALITY & SAFETY HEALTH CARE 235, 235 (2007).

99. See BARRY R. FURROW ET AL., HEALTH LAW 840 (2d ed. 2000).

100. Physicians as advisors is a trend that is likely to grow as medicine transforms from a model of paternalism, where the physician knows what's best, to a model of patient autonomy, where patients make their own decisions after full disclosure. For a popular account of this historical shift, see BARRON H. LERNER, *THE GOOD DOCTOR* x–xi, xiv (2014).

101. See TOM L. BEAUCHAMP & JAMES F. CHILDRESS, *PRINCIPLES OF BIOMEDICAL ETHICS* 312 (5th ed. 2001) (“The patient-physician relationship is founded on trust and confidence; and the physician is therefore necessarily a trustee for the patient’s medical welfare.”); S. SANDY SANBAR, ET AL., *LEGAL MEDICINE* 245 (5th ed. Mosby 2001) (“The relationship between patient and physician is one known to the law as a ‘fiduciary relationship’ (good faith and trusting).”); E.C. Hui, *Doctors as Fiduciaries: Do Medical Professionals Have the Right Not to Treat?*, 3 *POIESIS & PRACTICE* 256, 274 (2005).

102. FURROW ET AL., *supra* note 99, at 328; see Peter Bartlett, *Doctors as Fiduciaries: Equitable Regulation of the Doctor-Patient Relationship*, 5 *MED. L. REV.* 193, 199 (1997).

In *Hahn v. Mirda*,<sup>103</sup> a patient was told she had an aggressive form of cancer and treatment would likely be unsuccessful.<sup>104</sup> She underwent intensive chemotherapy and had a radical mastectomy.<sup>105</sup> The diagnosis turned out to be erroneous, but the doctors did not tell the patient the truth when they learned of it; instead, she found out two years later when one of the physicians testified about her situation in a deposition.<sup>106</sup> The court held that the doctors had a fiduciary duty to inform the patient that she did not have cancer when they became aware of the facts.<sup>107</sup> The doctor–patient relationship, the court explained, is a fiduciary relationship, and a doctor is prohibited from misrepresenting the nature of the patient’s condition.<sup>108</sup> The physicians in *Hahn* lacked power or authority over the patient’s care when the breach occurred.<sup>109</sup> Although the physicians may have had discretion over the patient’s treatment at the time of her procedure, when the physicians realized that the diagnosis was faulty, the procedure was long over.<sup>110</sup>

Similarly, in *Lockett v. Goodill*,<sup>111</sup> a patient underwent a successful appendectomy but was paralyzed in both legs after the operation.<sup>112</sup> The patient sued for negligence, and the defendants argued that the plaintiff had signed a liability release when settling with the hospital’s insurance agent.<sup>113</sup> When the patient signed the release, however, he had incomplete information—he believed he would be without use of his legs for only one year and, therefore, he agreed to settle for payments of \$108 per week for one year.<sup>114</sup> The court held that the physician–patient relationship is a fiduciary relationship “of the highest degree,” and the plaintiff’s physicians had a fiduciary duty to inform him that his assumption regarding use of his legs was likely wrong.<sup>115</sup> In both *Hahn* and *Lockett*, the physicians lacked discretion over the plaintiffs’ care once the surgery was complete. They had no discretionary power, but they were

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103. 54 Cal. Rptr. 3d 527 (Ct. App. 2007).

104. *Id.* at 528–29.

105. *Id.* at 529.

106. *Id.*

107. *See id.* at 532.

108. *Id.*

109. *See id.* at 529.

110. *See id.*

111. 430 P.2d 589 (Wash. 1967) (per curiam).

112. *Id.* at 590.

113. *Id.*

114. *Id.*

115. *Id.* at 591.

responsible for a fiduciary breach as a result of the failure to advise about the patients' condition.<sup>116</sup>

In the case of physicians, failure to disclose information post-procedure, as in the examples above, can be contrasted with failure to disclose pre-procedure. In pre-procedure cases, plaintiffs often allege breach of fiduciary duty for physicians' failure to disclose facts that are material to obtaining consent to treatment.<sup>117</sup> In pre-procedure cases, courts are concerned about whether a decision to submit to treatment truly rests with the patient as opposed to the doctor if full disclosure is not forthcoming. Thus, in pre-procedure disclosure cases, one might say that the physician, although acting as an advisor, has discretion or control over the patient's condition.<sup>118</sup> By contrast, in post-procedure cases, such as *Hahn* and *Lockett*, this type of physician control is absent because the procedure has already occurred. In post-procedure cases, one cannot claim that the physician has discretion or control over the patient's condition. Notwithstanding this lack of discretion, courts impose a fiduciary duty.

## 5. Lawyers

Some fiduciaries are regarded as owing stronger obligations than others, and lawyers top the list.<sup>119</sup> Stephen Gillers has written that, as a fiduciary, a lawyer must treat clients fairly and place their interests above

116. See *Tetstone v. Adams*, 373 So. 2d 362, 363 (Fla. Dist. Ct. App. 1979) (recognizing that a fiduciary relationship exists between a physician and a patient, imposing on the physician a duty to disclose known facts to the patient about her condition).

117. See, e.g., *Moore v. Regents of the Univ. of Cal.*, 793 P.2d 479, 483 (Cal. 1990).

118. See *id.* at 483–85 (recognizing that a person of “sound mind has the right, in the exercise of control over his own body, to determine whether or not to submit to . . . medical treatment,” and a physician seeking patient’s consent must disclose the physician’s personal, economic, or research interests to satisfy the physician’s fiduciary obligation (quoting *Cobbs v. Grant*, 8 Cal. 3d 229, 242 (1972))).

119. See *Peters v. Thedford*, No. 94-60250, 1995 WL 413016, at \*2 (5th Cir. June 13, 1995) (per curiam) (“The rule is well settled that the relationship of an attorney to his client is one of *uberrima fides*, and transactions between them affecting the subject matter which the attorney is employed to protect will be strictly scrutinized . . .” (quoting *Johnson v. Cofer*, 113 S.W.2d 963, 965 (Tex. Ct. App. 1938))); *In re Howrey LLP*, No. 11-31376DM, 2014 WL 5311258, at \*8 (Bankr. N.D. Cal. Oct. 17, 2014) (“The relationship between attorney and client is a fiduciary relation of the very highest character, and binds the attorney to most conscientious fidelity—*uberrima fides*.”), *aff’d sub nom. McGrane v. Howrey, LLP*, No. 14-cv-05111-JD, 2015 WL 6126792 (N.D. Cal. Oct. 19, 2015), *aff’d sub nom. In re Howrey LLP*, 698 F. App’x 881 (9th Cir. 2017). Gillers gives three reasons for the status of lawyers as being owed stronger fiduciary duties. See STEPHEN GILLERS, REGULATION OF LAWYERS 70–71 (9th ed. 2012). First, a client depends on the lawyer’s integrity, fairness, and knowledge, and will set aside usual caution when dealing with a lawyer. *Id.* Second, a lawyer might have confidential information about a client, thereby giving the lawyer an unfair advantage when dealing with the client. *Id.* at 71. Third, a client often cannot change her lawyer and is therefore dependent on him. *Id.*

all others with respect to the representation.<sup>120</sup> In certain contexts, a lawyer makes decisions on a client's behalf and, in that regard, acts with discretion. When litigating, for example, a lawyer must often think on her feet, acting, speaking, and arguing for a client without checking with the client first.<sup>121</sup> By contrast, when a lawyer advises a client on a legal matter, such as whether to litigate or settle, enter into an agreement, or execute a transaction, the lawyer is not making decisions for the client; she is providing her judgment on the best course of action, leaving ultimate decision-making in the client's hands.

The lawyer's advisory role is common.<sup>122</sup> Most lawyers spend their time not in the courtroom but rather in their offices counseling clients—they are on the phone, drafting emails or memoranda, or otherwise advising on discrete issues.<sup>123</sup> Acting as a counselor or advisor requires the lawyer to understand the legal issues before her as well as the broader personal or business contexts in which the legal issues arise.<sup>124</sup> The lawyer as counselor generally does not have discretion over the client's assets or affairs; it is the other way around—the lawyer as advisor acts to promote the client's discretionary authority.<sup>125</sup> Charles Wolfram has explained that the lawyer will typically perceive her role as a non-preemptive counselor, that is, counseling without preempting important areas of client autonomy.<sup>126</sup> Unlike litigation, which is retrospective, counseling is prospective and preventive. The idea is to avoid litigation by helping the client plan and strategize to achieve his ends.<sup>127</sup>

When an attorney acts in an advisory capacity, an attorney–client relationship is formed, and the attorney owes a fiduciary duty to the

120. GILLERS, *supra* note 119, at 70.

121. A lawyer often acts as the client's agent doing things directly attributable to the client. Gerald J. Postema, *Moral Responsibility in Professional Ethics*, 55 N.Y.U. L. REV. 63, 76–77 (1980) (explaining that a lawyer becomes an extension of legal and moral personality of the client).

122. See, e.g., *In re SRC Holding Corp.*, 364 B.R. 1, 26 (D. Minn. 2007), *rev'd sub nom. Leonard v. Dorsey & Whitney LLP*, 553 F.3d 609 (8th Cir. 2009); *Admiral Merchs. Motor Freight, Inc. v. O'Connor & Hannan*, 494 N.W.2d 261, 265–66 (Minn. 1992); *Togstad v. Vesely, Otto, Miller & Keefe*, 291 N.W.2d 686, 692 (Minn. 1980); see also Richard A. Corwin, *Ethical Considerations: The Attorney-Client Relationship*, 75 TUL. L. REV. 1327, 1342 (2001) (explaining that a lawyer becomes an advisor as a natural consequence of the attorney–client relationship).

123. CHARLES W. WOLFRAM, *MODERN LEGAL ETHICS* 688 (student ed. 1986).

124. The ABA's Model Rule 2.1 provides that in rendering advice, a lawyer can refer not only to the law, but also to moral, economic, social, and political factors relevant to the client. MODEL RULES OF PROF'L CONDUCT r. 2.1 (AM. BAR ASS'N 1983).

125. See *id.* at r. 2.1 cmt. 1; see also Alice Woolley, *The Lawyer as Fiduciary: Defining Private Law Duties in Public Law Relations*, 65 U. TORONTO L.J. 285, 311–12 (2015).

126. WOLFRAM, *supra* note 123, at 688.

127. *Id.* at 691.

client.<sup>128</sup> A difficult question is whether a court will treat a claim against a lawyer-advisor as a negligence and legal malpractice claim, or as a breach of fiduciary duty claim. If the gist of the claim is that the attorney did not exercise the proper degree of care, skill, or diligence, then the claim is one of negligence.<sup>129</sup> However, if the claim is that the lawyer failed to disclose a conflict of interest, failed to withdraw in light of a conflict, or failed to advise a client to retain separate counsel, then the claim is a proper breach of fiduciary duty claim.<sup>130</sup>

A good example is a fee claim brought by a group of plaintiffs who suffered property damage from plumbing systems made from defective polybutylene pipes.<sup>131</sup> The plaintiffs sued their lawyers, Fleming, Hovencamp & Grayson, P.C. (FH&G), for breach of fiduciary duty and legal malpractice for seeking excessively high fees and failing to disclose a conflict of interest.<sup>132</sup> Under a series of contingency fee agreements, FH&G was entitled to a 40% fee for sums recovered by judgment or settlement, and a 45% fee if the matter was appealed.<sup>133</sup> Settlement was reached with two manufacturers, which called for payments of \$170 million and replacing plumbing in the plaintiffs' property.<sup>134</sup> Several months later, after the settlement was finalized, the court ordered a series of fairness hearings to determine whether the attorneys' fees and expenses were reasonable.<sup>135</sup> At the fairness hearing stage, FH&G had a conflict of interest: it was in the firm's interest to have the fees upheld; it was in the plaintiffs' interest to have the court lower the fees because they were excessive.<sup>136</sup>

The lawyers did not disclose their conflict of interest with their clients in connection with the fairness hearings.<sup>137</sup> It was only after the court lowered the fees, and the attorneys filed their appeal, that they acknowledged to the plaintiffs that the fee issue raised a conflict.<sup>138</sup> Note that at the fairness hearing stage, when the lawyers failed to disclose their conflict, they had no discretionary authority over their clients' affairs.

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128. *Developments in the Law—Conflicts of Interest in the Legal Profession*, 94 HARV. L. REV. 1244, 1322 (1981); see also *In re Makowski*, 374 A.2d 458, 460 (N.J. 1977) (“The fact that the advice in this instance was more of a business than of a legal nature, does not relieve respondent of a duty to adhere to the high ethical standards exacted of a lawyer.”).

129. *Deutsch v. Hoover, Bax & Slovacek, LLP*, 97 S.W.3d 179, 189 (Tex. App. 2002).

130. See *id.* at 189–90.

131. *Spera v. Fleming, Hovencamp & Grayson, P.C.*, 25 S.W.3d 863, 866 (Tex. App. 2000).

132. *Id.*

133. *Id.* at 867.

134. *Id.*

135. *Id.*

136. See *id.*

137. See *id.*

138. *Id.*

The case had effectively concluded; the only open issue was whether the previously negotiated fee would be lowered. The key question was whether the lawyers had a duty to tell the plaintiffs about the potential conflict of interest in time for them to secure other counsel to represent them at the fairness hearing.<sup>139</sup> The court of appeals ruled that the lawyers had such a duty, reversed the ruling on the breach of fiduciary duty claim, and remanded the case for further proceedings.<sup>140</sup>

A variety of advisors owe clients fiduciary duties although the advisors lack discretion over the clients' assets or affairs. Business advisors, investment advisors, stockbrokers, physicians, and lawyers all have been deemed fiduciaries subject to duties of loyalty and care in their advisory capacity. As the next Section shows, acting in an advisory capacity will, in some cases, convert a non-fiduciary relationship to a fiduciary relationship, demonstrating a link between advice giving and a fiduciary obligation.

### C. *The Importance of Advice in Creating Fiduciary Relationships*

The previous Section demonstrated that courts often hold that advisors, even those who lack discretionary authority, are fiduciaries. Furthermore, providing advice can be a trigger that transforms a non-fiduciary relationship into a fiduciary one. Certain courts point specifically to advice as the essential conduct that creates a fiduciary relationship. Examples can be found in cases adjudicating disputes over auditors' and underwriters' duties. Auditors and underwriters are typically not considered fiduciaries. When they step outside of their traditional roles, however, and provide advice to clients, the advisory role transforms the non-fiduciary relationship into a fiduciary one with respect to the advice provided.

Let us first look at auditors. In *In re Cendant Corp. Securities Litigation*,<sup>141</sup> Cendant alleged that Ernst & Young (E&Y) breached its fiduciary duty of care, among other ways, by failing to discover accounting irregularities perpetrated by former senior management and failing to bring the irregularities to management's attention.<sup>142</sup> E&Y

139. *Id.* at 873.

140. *Id.* at 874; *see also* *Li Che v. Hsien Cheng Chang*, No. PX 16-2665, 2017 WL 3383038, at \*11, \*15 (D. Md. Aug. 7, 2017) (denying motion to dismiss breach of fiduciary duty claim against attorney who provided advice to two parties whose interests conflicted); *BCCI Holdings (Luxembourg), S.A. v. Clifford*, 964 F. Supp. 468, 481–82 (D.D.C. 1997) (denying motion to dismiss a breach of fiduciary duty claim against lawyers when the lawyers were advising two entities while the first entity was planning to acquire a subsidiary of the second).

141. 139 F. Supp. 2d 585 (D.N.J. 2001).

142. *Id.* at 608.

argued that auditors are not fiduciaries to their audit clients.<sup>143</sup> The firm maintained that the very nature of being an “independent” public accountant means that the accountant’s fidelity is to public investors, not the audit client.<sup>144</sup> Although the court agreed that the accountant–client relationship is generally not a fiduciary relationship, it found an exception for accountants who provide advice.<sup>145</sup> “[W]hen the auditor’s relationship goes beyond merely rendering an independent audit and providing investment advice, such a [fiduciary] relationship may exist.”<sup>146</sup> Cendant alleged that E&Y’s work went beyond providing an independent audit; rather, E&Y provided advice upon which it knew Cendant would rely.<sup>147</sup> The court held that those facts, if proven, would establish a fiduciary relationship.<sup>148</sup>

Another context in which advice can transform a non-fiduciary relationship into a fiduciary relationship is securities underwriting. In *EBC I, Inc. v. Goldman, Sachs & Co.*,<sup>149</sup> the New York Court of Appeals held that an underwriting agreement for an initial public offering (IPO) typically would not create a fiduciary duty for the underwriter.<sup>150</sup> However, an advisory relationship between an underwriter and issuer, marked by trust and confidence, would give rise to a fiduciary duty.<sup>151</sup> In the 1990s, eToys, Inc. decided to go public to obtain additional financing and retained Goldman as lead underwriter.<sup>152</sup> After eToys entered bankruptcy, unsecured creditors sued Goldman on behalf of the company.<sup>153</sup> The complaint alleged that eToys relied on Goldman’s advice, which Goldman provided without disclosing a conflict of interest.<sup>154</sup>

143. *Id.*

144. *Id.*; see also Arthur B. Laby, *Differentiating Gatekeepers*, 1 BROOK. J. CORP., FIN. & COM. L. 119, 124–26, 154–57 (2006) (discussing independence of auditors in contrast to other gatekeepers, such as lawyers).

145. *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d at 609.

146. *Id.*

147. *Id.* at 610.

148. *Id.*; see also *Burdett v. Miller*, 957 F.2d 1375, 1381–82 (7th Cir. 1992) (holding that the district court did not err in finding a fiduciary relationship when an accountant held himself out as expert investor thereby cultivating a relationship of trust on which the client relied).

149. 832 N.E.2d 26 (N.Y. 2005).

150. *Id.* at 31–32.

151. *Id.* at 31–33.

152. *Id.* at 29.

153. *Id.* at 30.

154. *Id.* Goldman arguably had an incentive to underprice eToys in the IPO, resulting in lower offering proceeds. *Id.* Goldman had entered arrangements with customers, which obligated them to repay Goldman a portion of their profits obtained from the sale of eToys shares after the IPO. *Id.* Thus, a lower IPO price would mean more customer profit and a higher Goldman payout. *Id.*

Goldman argued that the relationship between an issuer and underwriter is not fiduciary—it is a standard arm’s length relationship.<sup>155</sup> The court generally agreed but concluded, in this case, that the complaint alleged an advisory relationship as well.<sup>156</sup> eToys reposed confidence in Goldman’s knowledge and expertise to advise eToys as to the correct IPO price.<sup>157</sup> As a result of this advisory role, Goldman had a fiduciary obligation to disclose conflicts of interest, and the investment bank breached its duty by concealing its conflict.<sup>158</sup> The court isolated the advice as the subject of the fiduciary duty: “We stress, however, that the fiduciary duty we recognize is limited to the underwriter’s role as advisor.”<sup>159</sup>

Advisors who lack discretion over their clients’ affairs are often considered fiduciaries. Business advisors, investment advisors, brokers, doctors, and lawyers operate in a professional capacity advising their clients, and, in many instances, they lack discretionary authority over their clients’ assets or affairs. Nevertheless, they are considered fiduciaries and subject to the fiduciary duties of loyalty and care. Moreover, advice giving has been singled out as an activity that brings about a fiduciary relationship. Thus, not only are advisors often deemed fiduciaries, giving advice can serve as the key ingredient that triggers a fiduciary obligation. The next Part considers the importance of Part I for fiduciary theory.

## II. THE DISCRETIONARY AUTHORITY VIEW

In some cases, fiduciary relationships form when one party has discretion over a principal’s assets or affairs. It is ill-considered, however, to turn this single feature, common in many fiduciary relationships, into a generalized theory applicable to all. When discussing fiduciary duties, Joshua Getzler described this approach as the “base/superstructure” model, where a principle at the base supports a superstructure of detailed law.<sup>160</sup> This model, or something like it, has been employed by a number of writers in their attempts to arrive at a comprehensive theory of fiduciary relationships.<sup>161</sup>

Legal scholars who subscribe to the discretionary authority view focus on discretion as the essential feature of fiduciary relationships. They often articulate a theory of fiduciary relationships, based on discretion, with

155. *Id.* at 31.

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.* at 32.

160. Getzler, *supra* note 33, at 40.

161. See J. C. SHEPHERD, *THE LAW OF FIDUCIARIES* 51–91 (1981) (providing a discussion of eight theories, or groups of theories, of the fiduciary relationship).

two parts: (1) an explanation of when fiduciary relationships arise, and (2) a justification for imposing fiduciary obligations. As Part I demonstrated, discretion is not an essential feature of fiduciary relationships.

This Part explores in more detail the claims of those writers who promote the discretionary authority approach. It points to faults in the argumentation and explains why the approach is incomplete. This Part is divided into two primary sections. First, it discusses fiduciary status and the claim that discretion is a necessary feature of all fiduciary relationships. In doing so, it explains that this approach must be mistaken because the fiduciary advisors identified in Part I lack discretionary authority. Next, this Part examines the claims of several writers, including Professors Paul Miller, Lionel Smith, Evan Criddle, and Evan Fox-Decent, who support the discretionary authority view but who also recognize that advisors pose a challenge to that view. These writers try to reconcile the discretionary authority view with advisors' fiduciary duties. As I shall explain, however, their attempts leave too many unanswered questions and are ultimately unsuccessful.

Second, this Part discusses the proposed justification for fiduciary duties in the context of the discretionary authority approach. An emphasis on discretion has led to the claim that fiduciary duties are necessary to control the very discretion that purportedly characterizes fiduciary relationships and to protect principals from theft, self-dealing, or other harmful conduct that can occur when one has discretionary power over another. This justification, however, is ultimately unsatisfying as many fiduciaries lack discretionary authority. Later, in Part III, the Article proposes a justification for placing fiduciary duties on advisors that is not tied to discretionary authority.

### A. *Fiduciary Status*

This Section addresses whether fiduciary status arises strictly in the context of discretionary authority. For decades, many fiduciary scholars have maintained that fiduciary relationships arise only when one party has discretionary authority over another. These claims appeared nearly fifty years ago and persist today. Although not all writers insist that discretion is a necessary feature of fiduciary relationships, many—perhaps most—do. As this Section will elaborate, however, the discretionary authority approach fails from both descriptive and normative perspectives. Moreover, although some scholars recognize that advisors pose a challenge to the discretionary authority approach and attempt to address the challenge, this Section explains why those attempts ultimately are not persuasive.

## 1. The Dominance of the Discretionary Authority View

Generations of fiduciary scholars have identified discretion as the fundamental feature that sets fiduciary relationships apart from other legal relationships. Certain courts subscribe to the discretionary authority view as well. In *Varity Corp. v. Howe*,<sup>162</sup> the U.S. Supreme Court stated that, in the ERISA context, “the 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.”<sup>163</sup> In *United States v. Chestman*,<sup>164</sup> an insider trading case, the U.S. Court of Appeals for the Second Circuit stated that “[a] fiduciary relationship involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests.”<sup>165</sup> A leading Canadian case, *Frame v. Smith*,<sup>166</sup> held the same.<sup>167</sup> In some respects, statements by courts supporting the discretionary authority approach are unsurprising. After all, the archetype fiduciary is the trustee, who typically exercises control over trust assets. And fiduciary relationships developed, at least in part, by analogy from the trust relationship.<sup>168</sup>

Before going further, we should pause briefly and consider the meaning of the term “discretion.” Reference to the single word “discretion” masks the many ways the term is employed in fiduciary law and fiduciary theory. Some scholars adhere to a property-based view of discretionary authority, where a fiduciary is someone who controls tangible property belonging to a principal.<sup>169</sup> Others adhere to a power-based version, where discretion entails power over another’s affairs.<sup>170</sup> In most accounts discussed below, the fiduciary must have authority to

162. 516 U.S. 489 (1996).

163. *Id.* at 504 (emphasis omitted). This statement is puzzling given that, as discussed above, ERISA defines “fiduciary” to include any person who renders advice as well as any person who exercises discretion over the management of a plan or plan assets. 29 U.S.C. § 1002(21)(A) (2018). For a more detailed discussion of fiduciary status under ERISA, see Arthur B. Laby, *Trust, Discretion, and ERISA Fiduciary Status*, in *FIDUCIARY DUTIES IN BUSINESS* (Arthur B. Laby & Jacob H. Russell eds., forthcoming 2021).

164. 947 F.2d 551 (2d Cir. 1991) (en banc).

165. *Id.* at 569.

166. [1987] 2 S.C.R. 99 (Can.).

167. *Id.* at 136 (“Relationships in which a fiduciary obligation have [sic] been imposed seem to possess three general characteristics: (1) The fiduciary has scope for the exercise of some discretion or power. (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interests. (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.”).

168. See MATTHEW CONAGLEN, *FIDUCIARY LOYALTY* 12 (2010); Velasco, *supra* note 3, at 78.

169. See *infra* note 191 and accompanying text.

170. See *infra* notes 213–215 and accompanying text.

change the principal's legal or practical position.<sup>171</sup> Moreover, discretion does not mean the mere exercise of judgment on another's behalf. To be fair, the views of certain fiduciary scholars regarding the role of discretion have evolved as the field has matured. However, those espousing the discretionary authority approach generally employ a stronger definition of discretion than merely exercising judgment for another's benefit. To demonstrate the pervasiveness of the discretionary authority approach, I examine claims by a number of fiduciary scholars, including, when possible, the relevant meaning of discretion.

Many scholars argue that discretion is essential for a fiduciary relationship to arise.<sup>172</sup> Writing in 1975, Ernest Weinrib explained that two elements form the "core" of the fiduciary concept. First, the fiduciary must be able to exercise discretion; second, the fiduciary's discretion must be capable of affecting the principal's legal position.<sup>173</sup> Although Weinrib occasionally includes advice under the rubric of discretion, he refers not to general advisory services but rather to discretion to advise or negotiate in such a manner that will change the principal's legal position.<sup>174</sup> Thus, not only must Weinrib's fiduciary be vested with discretionary authority, she must also have sufficient authority to effectuate a change in the principal's legal status.<sup>175</sup> The reason agents, trustees, partners, and directors are fiduciaries, Weinrib maintained, is that they have discretion in dealing with third parties and can affect a principal's legal position.<sup>176</sup>

Other early writers on the fiduciary relationship echoed this theme. In the 1980s, Tamar Frankel wrote that fiduciary relationships have two "central feature[s]."<sup>177</sup> The first is that the fiduciary serves as a substitute for the principal, whom Frankel labeled an "entruster," because of the power the principal entrusts in the fiduciary.<sup>178</sup> A principal, Frankel explained, may wish to be relieved from performing certain functions,

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171. See *infra* notes 173–224 and accompanying text.

172. D. Gordon Smith & Jordan C. Lee, *Fiduciary Discretion*, 75 OHIO ST. L.J. 609, 610 n.6 (2014) ("Discretion is universally recognized as an essential aspect of fiduciary relationships.") (citing numerous sources to support the importance of discretion in fiduciary relationships).

173. 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.").

174. *Id.* at 7 ("The reason that agents, trustees, partners, and directors are subjected to the fiduciary obligation is that they have a leeway for the exercise of discretion in dealings with third parties which can affect the legal position of their principals.").

175. *Id.*

176. *Id.*

177. Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 808–09 (1983).

178. *Id.* at 808.

and instead engages the fiduciary to perform those functions for her.<sup>179</sup> The second central feature is that the fiduciary must obtain power from the principal or a third person to enable the fiduciary to act effectively.<sup>180</sup> Echoing Weinrib, Frankel explained that power enables the fiduciary to make changes that affect the entrustor.<sup>181</sup> As a result, Frankel's delegation of power goes beyond providing advice; the fiduciary's power must rise to the level where the fiduciary can change the principal's position. Two examples Frankel provides are transferring possession of securities to a broker and giving a broker discretion to trade on a customer's behalf.<sup>182</sup> In more recent writings, Frankel adheres to this view.<sup>183</sup>

Deborah DeMott has written extensively about fiduciary relationships. Over twenty-five years ago, DeMott reviewed theories of the fiduciary obligation and concluded that discretion is a common theme.<sup>184</sup> After summarizing various approaches, she wrote that the fiduciary obligation is a device that allows the law to respond to a number of situations where one person's discretion should be controlled because of aspects of that person's relationship with another.<sup>185</sup> "This instrumental description," DeMott concluded, "is the only general assertion about fiduciary obligation that can be sustained."<sup>186</sup> For DeMott, as for Weinrib and Frankel, discretion is a necessary condition before a fiduciary relationship can arise.<sup>187</sup>

In 1991, Robert Cooter and Bradley Freedman wrote an influential article analyzing the character of the fiduciary relationship.<sup>188</sup> Although they approach the subject from an economic perspective, they conclude that the fiduciary relationship is characterized by discretionary control.<sup>189</sup> In their view, fiduciary relationships entail a beneficiary entrusting a fiduciary with management and control over an asset.<sup>190</sup> Cooter and Freedman have a narrow view of discretion because, in their view, the

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179. *Id.*

180. *Id.* at 809.

181. *Id.* at 809 n.47 ("The term 'power' here means an ability to make changes that affect the entrustor.>").

182. *Id.* at 809.

183. FRANKEL, *supra* note 31, at 6; *id.* at 25 ("To perform their services, fiduciaries must be entrusted with various amounts of valuable assets and various degrees of discretion (power)."). Elsewhere in the book, Frankel appears to recognize that advisors without discretionary authority also can be fiduciaries, but with less onerous duties imposed. *See id.* at 9.

184. DeMott, *supra* note 33, at 915.

185. *Id.*

186. *Id.*

187. *Id.* at 901 ("If the relationship, as the parties structure it, does not confer discretion on the 'fiduciary,' then his actions are not subject to the fiduciary constraint.>").

188. Cooter & Freedman, *supra* note 37.

189. *See id.* at 1046.

190. *Id.* at 1046–47.

fiduciary controls a particular asset, such as cash, stock, land, a patent or copyright, or valuable information.<sup>191</sup> Thus, their description omits relationships where an agent has discretion over the principal's affairs but not over tangible or intangible property.<sup>192</sup>

These writers in the 1970s, 1980s, and early 1990s set the table for a newer generation of scholars, who advance the discretionary authority thesis. Gordon Smith maintains that there are three core requirements of a fiduciary relationship.<sup>193</sup> One of those requirements is that the fiduciary exercise discretion over a resource belonging to the principal.<sup>194</sup> Smith explains that non-fiduciary contracts also entail discretion, but the discretion vested in a contracting party is discretion over how to perform a contract.<sup>195</sup> What makes a fiduciary special is the fiduciary's discretion over critical resources of the principal.<sup>196</sup> According to Smith, this additional measure of discretion is what justifies placing heightened duties on fiduciaries as opposed to other contracting parties.<sup>197</sup>

Henry Smith also views discretion as central to fiduciary relationships. Henry Smith, however, rejects Gordon Smith's limitation that discretion must be over a critical resource.<sup>198</sup> According to Henry Smith, fiduciary relationships are not limited to those where one has discretion over a property interest or another critical resource.<sup>199</sup> Henry Smith uses the example of physicians as fiduciaries, explaining that fiduciary rules should apply to physicians who profit from a physician-patient relationship that does not involve informed consent.<sup>200</sup> Matthew Harding subscribes to this view as well, stating that "it seems [] plausible

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191. *Id.* at 1048 n.6.

192. The literature is not monolithic. Some writers recognize that fiduciary relationships are not limited to cases of discretionary authority. In 1981, J.C. Shepherd wrote that the fiduciary relationship had not been properly defined. SHEPHERD, *supra* note 161, at 4. He concluded that a person can create a fiduciary obligation by offering to give advice in a particular manner. *Id.* at 28–29.

193. Smith, *supra* note 37, at 1402.

194. *Id.* The other requirements are the fiduciary acting on behalf of the principal and exercising discretion over a critical resource of the principal. *Id.*

195. *Id.* at 1403.

196. *Id.* at 1448.

197. *Id.*

198. Henry E. Smith, *Why Fiduciary Law is Equitable*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 279.

199. *Id.*

200. *Id.* at 280. It is unclear whether Henry Smith would consider physicians who act as advisors to be fiduciaries. It seems not because he refers to fiduciary discretion as fundamental to the fiduciary relationship. *See id.* at 275, 278.

to assert that fiduciary discretion is a necessary condition of a fiduciary relationship, even if it is not a sufficient one.<sup>201</sup>

In their book, *Fiduciaries of Humanity*, Evan Criddle and Evan Fox-Decent make a similar claim in the public law context.<sup>202</sup> Criddle and Fox-Decent argue that the relationship between the state and its subjects is fiduciary in nature.<sup>203</sup> Fundamental to the structure of fiduciary relationships, they conclude, is that one party (the fiduciary) has discretionary authority over the legal or practical interests of another (the principal).<sup>204</sup> The fiduciary is authorized to make choices on the principal's behalf in the absence of specific instructions.<sup>205</sup> Criddle and Fox-Decent cite examples of discretionary power that include an agent's power to contract on a principal's behalf and an attorney's power to present claims and defenses on a client's behalf.<sup>206</sup> At the end of the book, Criddle and Fox-Decent briefly discuss financial advisors as fiduciaries; this Article addresses their discussion in Section II.A.3 below.

In a 2014 collection of papers on the fiduciary obligation, scholars from seven countries presented various approaches to the fiduciary relationship.<sup>207</sup> Although the papers have little in common, a persistent theme is that fiduciaries have discretion over their principals' assets or affairs. In his contribution, the Honorable Justice James Edelman explains that in Australia, discretion is a critical feature of fiduciary relationships.<sup>208</sup> A fiduciary relationship is one where the fiduciary acts on another's behalf "in the exercise of a power or discretion" which will affect the other person's interest either legally or practically.<sup>209</sup> Joshua Getzler explains that courts in the United Kingdom tend to impose fiduciary duties when one party has continuing authority or power over another.<sup>210</sup> Historically, according to Getzler, before a fiduciary duty

201. Matthew Harding, *Fiduciary Relationships, Fiduciary Law, and Trust*, in RESEARCH HANDBOOK ON FIDUCIARY LAW, *supra* note 3, at 58, 67.

202. See CRIDDLE & FOX-DECENT, *supra* note 3, at 18; see also Evan Fox-Decent, *The Fiduciary Nature of State Legal Authority*, 31 QUEEN'S L.J. 259, 259 (2005) (exploring the "deeply fiduciary" nature of the relationship between a sovereign and its subjects).

203. CRIDDLE & FOX-DECENT, *supra* note 3, at 31.

204. *Id.* at 18.

205. *Id.*

206. *Id.*; see also Fox-Decent, *supra* note 202, at 300 ("The kind of discretionary power in play is one that implies a measure of control over the interests of another, such as a trustee's control over the disposition of an estate, or a managing director's control over the direction a company takes.").

207. PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3.

208. James Edelman, *The Role of Status in the Law of Obligations: Common Callings, Implied Terms, and Lessons for Fiduciary Duties*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 22, 25.

209. *Id.* (quoting *Hosp. Prods. Ltd. v. U.S. Surgical Corp.* (1984) 156 CLR 41, 76 (Austl.)).

210. Getzler, *supra* note 33, at 43.

would arise, a person must have continuous control over another's assets or affairs and be accountable for those assets.<sup>211</sup>

Paul Miller has written that a fiduciary relationship is a distinctive type of legal relationship.<sup>212</sup> He defines it as a relationship where “one party (the fiduciary) exercises discretionary power over the significant practical interests of another” party.<sup>213</sup> According to Miller, possession of discretionary power over the practical interests of the principal is the “essential characteristic” of all fiduciary relationships.<sup>214</sup> Miller provides examples of discretion, such as entering into legally binding arrangements for another; acquiring, investing, using, administering, or alienating property for another; and making decisions relating to health and personal welfare for another.<sup>215</sup> Such exercise of discretionary authority presumably would not include providing advice when the advice neither binds the principal nor alters her legal position. Miller directly addresses advisory services, and this Article discusses his views below.

Hanoch Dagan and Sharon Hanes, Israeli scholars, focus on financial fiduciaries. They, too, regard discretionary authority as essential to fiduciary status.<sup>216</sup> Dagan and Hanes explain that financial fiduciaries must be sensitive to the incentive structures inherent in the activity of managing others' money, which they say implies a discretionary authority particularly susceptible to carelessness and abuse.<sup>217</sup> Irit Samet, who espouses a Kantian view of fiduciary loyalty, believes that the juridical duty of loyalty applies only when the fiduciary exercises discretion.<sup>218</sup> “The whole point” of the fiduciary relationship, she writes, referencing Cooter and Freedman, is to allow an expert to exercise discretion in situations that cannot be defined with precision in advance.<sup>219</sup> Lionel Smith, a Canadian private law scholar and an expert on trust law, also believes that discretion is a necessary feature of fiduciary relationships.<sup>220</sup> Lionel Smith writes: “[O]ne of the core features of the fiduciary relationship is that the fiduciary *always* holds

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211. *Id.*

212. Miller, *supra* note 3, at 69.

213. *Id.*

214. *Id.* at 90.

215. *Id.* at 71.

216. Hanoch Dagan & Sharon Hanes, *Managing Our Money: The Law of Financial Fiduciaries as a Private Law Institution*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 91–92.

217. *Id.*

218. Irit Samet, *Fiduciary Loyalty as Kantian Virtue*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 132, 135.

219. *Id.* (citing Cooter & Freedman, *supra* note 37, at 1046).

220. Smith, *Can We Be Obligated*, *supra* note 3, at 154.

discretionary powers for the benefit of the beneficiary.”<sup>221</sup> Lionel Smith further explains that fiduciary law is needed only “where there are discretionary powers (including the giving of advice).”<sup>222</sup> I address Lionel Smith’s reference to advice below.

It cannot be overemphasized that these scholars view discretion as a necessary condition for a fiduciary relationship to arise. Gordon Smith and Jordan C. Lee write: “[T]he grant of discretion in fiduciary relationships is not merely an artifact of bounded rationality, but a crucial part of the bargain.”<sup>223</sup> Miller states: “The Court in *Galambos* has thus clearly resolved that discretionary power is an essential characteristic of all fiduciary relationships.”<sup>224</sup>

Several writers appear to take a more relaxed view of discretion, indicating that discretion is a *sufficient* but perhaps not a *necessary* feature of fiduciary relationships. Robert Sitkoff, who espouses an economic view of fiduciary obligations, suggests that discretion is a sufficient condition for a fiduciary relationship to arise.<sup>225</sup> Certain categories of professionals, he writes, such as trustees, guardians, agents, and directors have the kind of discretionary power to affect a principal’s welfare.<sup>226</sup> As a result, these individuals are fiduciaries.<sup>227</sup> Ethan Leib and Stephen Galoob insist that “[a] fiduciary relationship *traditionally* emerges in contexts where one person (the fiduciary) has discretionary power over the assets or legal interests of another (the beneficiary).”<sup>228</sup> Leib and Galoob, therefore, do not necessarily exclude individuals or firms that lack discretion as fiduciaries.<sup>229</sup> Most writers discussed in this

221. *Id.*

222. *Id.* at 154 n.62.

223. Smith & Lee, *supra* note 172, at 631.

224. Paul B. Miller, *A Theory of Fiduciary Liability*, 56 MCGILL L.J. 235, 263 (2011).

225. Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 197, 200.

226. *Id.*

227. *Id.* Lionel Smith writes that a fiduciary duty applies in any situation where “one person holds authority to make discretionary decisions” that affect another person’s legal status. Smith, *Can We Be Obligated*, *supra* note 3, at 148. He adds a second characteristic, namely, that the discretion must be given under a proper grant of authority to another to manage her affairs. *Id.* This language indicates that discretion is sufficient for a fiduciary relationship but perhaps not necessary. Later in the same paper, however, Smith suggests that discretion is a necessary feature, without saying so explicitly. *See id.* at 154. He writes that a core feature of the fiduciary relationship “is that the fiduciary *always* holds discretionary powers for the benefit of the beneficiary.” *Id.*

228. Ethan J. Leib & Stephen R. Galoob, Essay, *Fiduciary Political Theory: A Critique*, 125 YALE L.J. 1820, 1825 (2016) (emphasis added).

229. *See* Stephen R. Galoob & Ethan J. Leib, *Fiduciary Loyalty, Inside and Out*, 92 S. CAL. L. REV. 69, 119–20 (2018) (discussing applicability of fiduciary duties to those engaged in advisory activities).

Section, however, believe that discretion is a necessary condition of a fiduciary relationship.

Although the discretionary authority view is pervasive in the literature on fiduciary relationships, there are some skeptics. In critiquing Miller's approach, Julian Velasco argues that, as a practical matter, the discretionary authority approach is an inaccurate descriptive account of fiduciary relationships.<sup>230</sup> Velasco argues that although discretionary authority may be a paradigmatic form of fiduciary power, it is not a necessary component.<sup>231</sup> Velasco, however, appears to believe that all fiduciaries exercise the beneficiary's legal capacity. A purely advisory relationship, however, seems to contradict Velasco's claims.

Similarly, Evan Criddle has stated that although a person may be a fiduciary if she holds discretionary power, it does not follow that a person must hold discretionary authority to qualify as a fiduciary.<sup>232</sup> In Criddle's view, "[A] party is a fiduciary if she has been entrusted with power over another party's legal or practical interests."<sup>233</sup> According to Criddle, power is the ability "to dictate how another's legal rights or powers will be exercised" and would include an "investment adviser."<sup>234</sup> However, a purely advisory relationship, where the advisor has no ability to dictate how another will exercise his rights, seems to contradict Criddle's approach.

Another academic commentator to question the discretionary authority view is Robert Flannigan.<sup>235</sup> When writing about advice by lawyers, Flannigan states that discretion is not the "essential criterion or determinant" for fiduciary accountability.<sup>236</sup> Legal advice, according to Flannigan, does not involve the exercise of discretion, yet it can be compromised by a conflict of interest or improper benefits.<sup>237</sup> Velasco, Criddle, and Flannigan have laid the foundation of explaining the drawbacks to the discretionary authority approach, which is the subject of the next subsection.

## 2. The Challenge to the Discretionary Authority View

Although the discretionary authority view may describe certain fiduciary relationships, it does not adequately describe all fiduciary

230. Velasco, *supra* note 3, at 83, 86.

231. *Id.* at 83–84, 86.

232. Criddle, *supra* note 3, at 1036.

233. *Id.* (emphasis omitted).

234. *Id.* at 1037.

235. See Robert Flannigan, *Fiduciary Mechanics*, 14 CANADIAN LABOUR & EMP. L.J. 25, 38–39 (2008).

236. *Id.* at 38.

237. *Id.* at 38–39.

relationships and is therefore inadequate as a descriptive theory of fiduciary duties.<sup>238</sup> Part I demonstrated that many courts conclude that advisors are fiduciaries although they lack discretion over the principal's assets or affairs. Thus, to the extent that the discretionary authority view holds that discretion is a necessary feature to form a fiduciary relationship, the approach must be erroneous. Many advisors lack discretion but are nonetheless considered fiduciaries. A weaker form of the discretionary authority view, whereby discretion is sufficient but not necessary to form a fiduciary relationship, might be supportable. The dominant view held by fiduciary scholars, however, is that discretion is an essential component of fiduciary relationships. In that regard, the approach is too reductionist and must be reconsidered.

The discretionary authority approach fails from a normative perspective as well. There is no essential link between discretion over a principal's assets or affairs and the imposition of the duties of loyalty and care—no reason discretion and the fiduciary obligation are necessarily yoked together.<sup>239</sup> To support the discretionary authority approach, there must be some reason that discretion, and not some other relational characteristic, must give rise to the duties of loyalty and care—the essential duties imposed on fiduciaries. One can imagine arguments that other relational characteristics, such as holding property on another's behalf or exercising influence over another's affairs, could also give rise to fiduciary duties. The challenge for those who promote the discretionary authority approach is to explain why discretion, as opposed to other relational qualities, is necessary before a fiduciary relationship can arise.

In fact, one might argue that those who favor the discretionary authority approach have it backwards. Instead of a fiduciary necessarily having discretionary power over a principal, the fiduciary duty helps ensure that a principal is able to maintain *discretion over her own affairs*. A fundamental precept of the law of agency is that the agent (the fiduciary) acts subject to the principal's control—not the other way around.<sup>240</sup> Alice Woolley explains that not only does a lawyer lack

238. This Article focuses on advisors to disprove the discretionary authority approach. However, certain other fiduciaries, which this Article does not discuss, similarly lack discretion. For example, a single director on a multi-director board lacks discretion over the corporation, its property, or its affairs. Only the board acting as a whole has such power. Del. Code Ann. tit. 8, § 141(a) (2019). Yet, a single director is most certainly a fiduciary. *See, e.g., Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939). The Author thanks Lyman Johnson for this example.

239. *See SHEPHERD*, *supra* note 161, at 87 (arguing that the discretionary authority approach “tells us nothing about how the duty is attached to the fiduciary” and without this connection, “what we are left with is a theory which is descriptive, not analytic”).

240. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006). Although an agent can have power to affect the legal rights and duties of a principal, the very definition of “agency”

discretion over her client's affairs, a lawyer has a legal and ethical obligation to leave decision-making authority in the client's hands.<sup>241</sup> The structure of the attorney–client relationship is designed to enable a client to exercise discretion, not to enable the lawyer to exercise discretion on the client's behalf.<sup>242</sup> Similarly, J.E. Penner refers to advisory fiduciaries, such as lawyers, as “epistemic authorities.”<sup>243</sup> They do not undertake transactions on a principal's behalf; they advise a principal based on their expertise so that the principal can decide what to do after becoming informed about the effects of a particular body of knowledge.<sup>244</sup>

One way to reconcile the discretionary authority view of fiduciary relationships with the advisors discussed in Part I is to define discretion broadly enough to encompass the giving of advice. Most advisors employ some measure of what one potentially could call “discretion” in formulating their advice, particularly if the advice is prospective. A capacious definition of discretion, which would accommodate advisory services, however, is not what most fiduciary scholars have in mind when they refer to a fiduciary's discretionary authority.<sup>245</sup> Rather, they have in mind discretion that entails power or authority over an asset, or over the

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posits that the agent acts subject to the principal's control. *See id.* cmt. c (“The person represented has a right to control the actions of the agent.”).

241. Woolley, *supra* note 125, at 312; *see also* W. Bradley Wendel, *Understanding the Complex Loyalty of Lawyers: Dual-Commission, Governance Mandate, and Intrinsic-Limit Analyses* 20 (unpublished manuscript) (on file with author) (“Lawyers are fundamentally technicians, retained by their clients for their expertise in working with complex legal doctrines—again, with the end of facilitating the autonomy of clients to act on their own interests.”). This principle was affirmed by the U.S. Supreme Court in *McCoy v. Louisiana*, 138 S. Ct. 1500 (2018). In that case, the defendant, facing the death penalty in a homicide case, insisted on presenting a defense that lacked all credibility and would likely result in conviction and the death penalty. In contrast, his lawyer believed his client potentially could avoid the death penalty by conceding guilt and arguing at the penalty phase that the death penalty was unwarranted. *Id.* at 1505. Although the lawyer may have been strategically correct, the Court held that the decision to litigate ultimately rests with the client. *Id.* at 1509.

242. Woolley, *supra* note 125, at 288.

243. J.E. Penner, *Distinguishing Fiduciary, Trust, and Accounting Relationships*, 8 J. EQUITY 202 (2014), 2014 AJEQT LEXIS \*14, \*12.

244. *Id.*

245. One exception is J.E. Penner, who includes the exercise of judgment as part of the exercise of discretion. *Id.* at \*10. Accordingly, Penner also recognizes that advisors can be fiduciaries by virtue of giving advice. *Id.* Penner writes: “[I]n the case of an advisory fiduciary, such as a solicitor giving legal advice to her client, there may be more than one course of action open to the client, and in giving proper advice, the solicitor will have to exercise judgment . . . in providing that advice.” *Id.* According to Penner, the better word for exercising these particular powers is “judgment,” not “discretion,” but the literature refers to “discretion” and “‘discretionary’ powers,” and so he uses that formulation. *Id.* at \*10–11. In this Article's view, however, the disagreement between Penner and most others espousing a discretionary authority approach runs deeper. As explained in the text, most commentators view a strong form of discretionary authority to be an essential feature of fiduciary relationships.

principal's affairs, such that the fiduciary can change the principal's legal or practical position without the principal's prior acquiescence.<sup>246</sup>

Fiduciary scholars supporting the discretionary authority approach are clear about their views. The general idea, as discussed, is that a fiduciary has authority over the legal or practical interests of a principal. Weinrib writes that "the fiduciary must have scope for the exercise of discretion, and . . . this discretion must be capable of affecting the legal position of the principal."<sup>247</sup> Gordon Smith insists that the distinguishing feature of a fiduciary "is that a fiduciary exercises discretion with respect to a critical resource belonging to the beneficiary."<sup>248</sup> Miller has explained that the fiduciary "stands in substitution for the beneficiary or a benefactor in exercising a legal capacity that is ordinarily derived from the beneficiary or benefactor's legal personality."<sup>249</sup> These accounts of discretion are similar to the definition of discretion in the U.S. federal securities laws, which describes whether an investment account is considered discretionary or nondiscretionary. An advisor exercises discretion if she is authorized to determine which securities to buy or sell for an account or makes decisions about which securities to buy or sell.<sup>250</sup> It is this strong form of discretion that promoters of the discretionary authority approach have in mind.

### 3. Addressing the Challenge Posed by Advice

Several fiduciary scholars concede that advisors pose a challenge to the discretionary authority view. Paul Miller and Lionel Smith recognize that advisors pose a problem for their analysis, and Evan Criddle and Evan Fox-Decent address whether advice can fit into their structure. Thus, it is profitable to study the challenge as they see it—and their replies—to determine if the discretionary authority approach can withstand the challenge posed by advice giving.

246. See Weinrib, *supra* note 173, at 4.

247. *Id.*

248. Smith, *supra* note 37, at 1403; see also Smith & Lee, *supra* note 172, at 610–11 ("We contend that the grant of discretion in fiduciary relationships is not merely an artifact of human weakness, but a crucial part of the fiduciary bargain.").

249. Miller, *supra* note 3, at 70–71.

250. Securities Exchange Act of 1934 § 3, 15 U.S.C. § 78c(a)(35) (2018). In practice, the client gives the advisor authority akin to a power of attorney to trade on the client's behalf without checking with the advisor first. See Seth E. Lipner & Lisa A. Catalano, *The Tort of Giving Negligent Investment Advice*, 39 U. MEM. L. REV. 663, 667 n.12 (2009) ("In a discretionary account, the investment advisor holds power of attorney and makes the investment decisions. In a non-discretionary account, the advisor makes recommendations and provides advice, but the investor makes the final decision on whether to buy, sell or hold a particular security.").

Let us start with Miller,<sup>251</sup> who begins his analysis of advisors by comparing them to trustees. Miller states that many advisory relationships are characterized by trust and confidence.<sup>252</sup> Miller then asks why one should not conclude that advisors, in general, are fiduciaries.<sup>253</sup> He answers this question by stating that one should not draw this conclusion because it is not true.<sup>254</sup> Under Miller's view, "[A]dvisers are not fiduciaries by virtue of giving advice."<sup>255</sup> They are only fiduciaries, he says, "where they exercise discretionary power over the practical interests of their clients."<sup>256</sup> Miller thus challenges himself to demonstrate that advisors are not fiduciaries by virtue of advice giving.

To support the claim that advisors are not fiduciaries, Miller references an article by Jill Fisch, entitled *Fiduciary Duties and the Analyst Scandals*.<sup>257</sup> Fisch, however, does not state that advisors are not fiduciaries. Rather, Fisch discusses whether broker-dealers (not investment advisors) are considered fiduciaries to their clients. She explains that the law distinguishes between brokers and advisors and imposes fiduciary duties on the latter but not the former.<sup>258</sup> When Miller concludes that advisors are not fiduciaries, perhaps he is referring to broker-dealers in their advice-giving capacity. But this is only half of the story: regardless of how the law treats broker-dealers, investment advisors—a separate group of regulated professionals—are always considered fiduciaries under federal law, regardless of whether they exercise discretion over client accounts.<sup>259</sup>

Next, Miller relies on the Canadian Supreme Court case of *Hodgkinson v. Simms*<sup>260</sup> to support the claim that an advisory relationship is not inherently fiduciary.<sup>261</sup> A better reading of *Hodgkinson* is that advisory relationships are not *necessarily* fiduciary. Miller quotes *Hodgkinson*, which states that for an advisory relationship to be fiduciary, "there must be something more than a simple undertaking by one party

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251. See Miller, *supra* note 3, at 83–84 (discussing advisors as fiduciaries).

252. *Id.* at 83.

253. *Id.*

254. *Id.*

255. *Id.* at 84.

256. *Id.*

257. *Id.* at 83 n.72.

258. Jill E. Fisch, *Fiduciary Duties and the Analyst Scandals*, 58 ALA. L. REV. 1083, 1094–95 (2007) ("In the context of financial professionals, the law has traditionally drawn a line between investment advisers and broker-dealers, imposing broad fiduciary obligations only upon the former.").

259. See *supra* Section I.B.2.

260. [1994] 3 S.C.R. 377 (Can.).

261. Miller, *supra* note 3, at 83 & n.73.

to provide information and execute orders for the other.”<sup>262</sup> What did the Canadian Supreme Court mean by “something more”? The court was explicit that “something more” can simply mean trust, confidentiality, or complexity, and not necessarily discretionary authority.<sup>263</sup> Thus, according to *Hodgkinson*, an advisory relationship can be fiduciary in the presence of trust, confidentiality, or complexity, where the advisee reasonably expects the advisor to act in the client’s best interest, regardless of whether the advisor has discretion over the client’s account.<sup>264</sup> An advisory relationship characterized by trust is precisely what this Article contemplates with respect to advisors who are fiduciaries, as explained in Part III.

Finally, Miller returns to the example of broker-dealers and investment advisors in the United States, discussed by Fisch, to support his claim that discretion is essential for fiduciary relationships.<sup>265</sup> In his discussion, however, Miller focuses on brokers and ignores investment advisors. Under United States law, broker-dealers and investment advisors are two different groups of financial services professionals regulated under different statutes, the Securities Exchange Act of 1934<sup>266</sup> (for brokers) and the IAA<sup>267</sup> (for advisors). Like investment advisors, broker-dealers often give advice, but brokers are excluded from IAA coverage as long as they meet certain conditions.<sup>268</sup> Brokers typically are not considered fiduciaries, but investment advisors are fiduciaries.<sup>269</sup>

As Miller has said—and I agree—when brokers have discretion over a customer account, the normal rule changes and brokers are held to a fiduciary standard. However, as outlined in Section I.B.3 above, even

262. *Id.* at 83 (quoting *Hodgkinson*, [1994] 3 S.C.R. at 410).

263. *Hodgkinson*, [1994] 3 S.C.R. at 410 (“There are, however, other advisory relationships where, because of the presence of elements such as trust, confidentiality, and the complexity and importance of the subject matter, it may be reasonable for the advisee to expect that the advisor is in fact exercising his or her special skills in that other party’s best interests, unless the contrary is disclosed.”).

264. Miller also quotes the *Hodgkinson* dissent to support his claim. Miller, *supra* note 3, at 83 & n.75. First, the dissent refers to the “ceding . . . of effective power” which is not the same as power to affect the legal or practical interests of another. *Hodgkinson*, [1994] 3 S.C.R. at 466 (Sopinka & McLachin, J.J., dissenting) (stating that the key feature of an advisory relationship that gives rise to fiduciary duties is the “ceding . . . of effective power”). Second, although the dissent lends some support to Miller’s claims, the majority supports this Article’s argument.

265. Miller, *supra* note 3, at 84.

266. Ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a to 78qq (2018)).

267. Ch. 686, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1 to 80b-18c (2018)).

268. *Id.* § 202(a)(30)(C), 15 U.S.C. § 80b-2(a)(11)(C); *see supra* note 81.

269. SEC Rule Regulation Best Interest has enhanced the duties placed on broker-dealers, but the SEC stopped short of deeming broker-dealers to be fiduciaries. *See Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33,318, 33,322 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

brokers that lack discretion are considered fiduciaries when their advisory role becomes prominent.<sup>270</sup> Thus, for brokers, discretion is a relevant consideration, but it is not the sole determinant of fiduciary status. And as explained in Part I, under federal law, investment advisors, regardless of whether they have discretion, are always considered fiduciaries to their clients.<sup>271</sup> Consequently, for many advisors, discretion is not a relevant consideration with respect to fiduciary status.

Lionel Smith, whose work is discussed above, also recognizes that advice presents a challenge for the discretionary authority view of fiduciary duties.<sup>272</sup> Although Smith subscribes to the discretionary authority approach, he also recognizes that advisors are fiduciaries and dwells on how this might be possible.<sup>273</sup>

Smith attempts to fold advice into his account of discretionary power by claiming that giving advice is tantamount to control. Smith states that the duty of loyalty arises in “true advisory situations, where one person undertakes to advise another person to help that other person make their own decisions.”<sup>274</sup> In both situations (holding legal powers and giving advice), Smith states that “one person holds some control over another person, but holds that control on behalf of and for the benefit of the other person.”<sup>275</sup> Moreover, Smith has characterized an advisory relationship as one where there has been a “partial transfer of autonomy.”<sup>276</sup> Smith writes, “If . . . the advisor has effective power over the advisee’s decision-making process, there is a partial transfer of autonomy just as in the case of Hohfeldian powers.”<sup>277</sup> He states that advice entails an exercise of judgment and concludes that “[t]he giving of advice is a process that involves judgement, just as does the decision whether and how to use a legal or Hohfeldian power.”<sup>278</sup>

But there is no reason to conclude that a person acting in an advisory capacity “holds some control” over another. Similarly, there is no reason to conclude that an advisor has effective power over an advisee’s decision-making process. And although both advice giving and the exercise of legal powers involve judgment, it is a logical fallacy to claim that advice giving is tantamount to exercising legal powers.

270. See *supra* Section I.B.3.

271. See *supra* Section I.B.2.

272. Smith, *Can We Be Obligated*, *supra* note 3, at 157; Smith, *Fiduciary Relationships*, *supra* note 3, at 618.

273. Smith, *Fiduciary Relationships*, *supra* note 3, at 618–19.

274. Smith, *Can We Be Obligated*, *supra* note 3, at 148.

275. *Id.*

276. Smith, *Fiduciary Relationships*, *supra* note 3, at 618.

277. *Id.*; see also Velasco, *supra* note 3, at 88 (suggesting that in some cases, trusted advisors may have great influence and, therefore, effective control—de facto power—over their advisees).

278. Smith, *Fiduciary Relationships*, *supra* note 3, at 618.

The mere provision of advice does not connote control over another. In some cases, an advisor may exercise effective control over an advisee. But in many instances, an advisor will enumerate several possible courses of action and explain the advantages and disadvantages of each. Advice may influence a client's deliberative process, but the client is free to make her own decision. Moreover, the advisor may be acting for the advisee's benefit, but that hardly amounts to control. To the contrary, providing advice can be viewed as a way to allow a client—not the advisor—to exercise discretion in choosing among several courses of action after learning about the merits of each. As discussed above, the structure of an advisory relationship can also be seen as a way to enable a client to maintain control over her affairs, as opposed to ceding control or discretion to the advisor.<sup>279</sup>

Lionel Smith seems to concede that advisors pose an unanswerable challenge to the discretionary authority approach. It is clear, he writes, that some fiduciaries do not have strict legal or Hohfeldian powers.<sup>280</sup> Instead, they merely give advice without the power to bind their beneficiaries.<sup>281</sup> Smith places certain lawyers, investment advisors, real estate agents, and physicians in this category.<sup>282</sup> He cites to authority, supporting the point that many fiduciary duty cases arise in an advisory context.<sup>283</sup> Smith concludes that advice must be given in the best interest of the advisee, and courts do not hesitate to employ the panoply of fiduciary rules to the advisory context.<sup>284</sup> On these points, this Article agrees with Smith entirely.

Finally, recall briefly *Fiduciaries of Humanity*, where Criddle and Fox-Decent argue that fiduciary relationships arise when the fiduciary has discretionary authority over the legal or practical interests of the principal.<sup>285</sup> Near the end of the book, the authors take up financial advisors, who lack discretionary authority over client assets.<sup>286</sup> Criddle and Fox-Decent maintain that advisors have “factual power” to influence their clients' decisions but not legal authority to make the decisions.<sup>287</sup> In light of the clients' dependence and vulnerability, Criddle and Fox-Decent claim that advisors have “factual discretionary power” over a client's interests.<sup>288</sup> It is unclear, however, exactly what “factual

279. See Woolley, *supra* note 125, at 288.

280. Smith, *Can We Be Obligated*, *supra* note 3, at 157; Smith, *Fiduciary Relationships*, *supra* note 3, at 618.

281. Smith, *Can We Be Obligated*, *supra* note 3, at 157.

282. *Id.*

283. *Id.* at 157 & n.75.

284. *Id.*

285. CRIDDLE & FOX-DECENT, *supra* note 3, at 18.

286. *Id.* at 332–33.

287. *Id.*

288. *Id.*

discretionary power” means. One possibility is that the clients *always* follow their advisors’ advice. But Criddle and Fox-Decent do not argue for this definition.

In any case, “factual discretionary power” appears to be a far distance from the authors’ earlier account of discretion, which entails making choices on a principal’s behalf without specific instructions. If Criddle and Fox-Decent want to fit advice into a definition of factual discretionary power, and thereby into their earlier view of discretionary authority, they will have to amend their earlier definition. An overly broad definition of discretion, however, would be inconsistent with most scholars’ view of discretion as the ability to alter a principal’s legal or practical position.

Miller, Smith, and Criddle and Fox-Decent all seem to recognize that advisors pose a challenge to the discretionary authority view of fiduciary duties. Their attempts to square the activity of advisors with the discretionary authority approach, however, are ultimately unsuccessful.

### B. *Fiduciary Justification*

As explained in the previous Section, the discretionary authority approach does not adequately explain who is a fiduciary and when fiduciary duties arise. This Section explains the implications of deficiencies in the discretionary authority approach for the standard justification for imposing fiduciary duties. A common justification for imposing fiduciary duties is to control a fiduciary’s discretion and protect the principal from the harms of misappropriation, theft, and self-dealing that can occur if the fiduciary exercises discretion improperly. But if discretion is not a necessary feature of fiduciary relationships, then this justification is not always applicable and there must be other reasons to impose fiduciary duties. This Section briefly examines the argument that fiduciary duties are justified by the need to control the fiduciary’s discretion and concludes that the justification is incomplete.

Many writers link the justification for fiduciary duties to fiduciary status. If fiduciary status arises when an individual or firm exercises discretion over a principal’s assets or affairs, a natural question is *why* discretion gives rise to fiduciary duties. A standard reply is that discretion can be abused to harm the principal and thus must be controlled. Imposing fiduciary duties is one way to control the pernicious side of discretion. Fiduciary duties control the discretion that principals grant to their agents.

Many writers who view discretion as a necessary feature of fiduciary relationships also articulate a justification for fiduciary duties based on

controlling that very discretion.<sup>289</sup> In Weinrib's classic article, he provides a justification for fiduciary duties, which followed from the criteria used to determine when a fiduciary relationship arises.<sup>290</sup> Recall Weinrib's criteria: the fiduciary exercises discretion, and the discretion is capable of affecting the principal's legal position.<sup>291</sup> Weinrib explains that the principal's interests can be affected by the manner in which the fiduciary uses its discretion.<sup>292</sup> As a result, Weinrib writes, "The fiduciary obligation is the law's blunt tool for the control of this discretion."<sup>293</sup> Deborah DeMott's instrumental view of the fiduciary obligation is that it is a device that allows the law to respond to a variety of situations where one person's discretion must be controlled.<sup>294</sup>

Similarly, Tamar Frankel writes that the "main purpose" of fiduciary law is to prohibit fiduciaries from misappropriating or misusing property or power entrusted to them.<sup>295</sup> In an earlier writing, Frankel explains why a grant of discretionary authority leads one to worry about abuse, which

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289. See, e.g., Cooter & Freedman, *supra* note 37, at 1048 (explaining that both the fiduciary duty of loyalty and the fiduciary duty of care are mechanisms to control discretion); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1982) (explaining that fiduciary duties are socially optimal penalties that enable parties to capture the benefits obtained from delegating authority while also constraining the fiduciary from taking advantage of the principal or otherwise furthering the fiduciary's interests as opposed to the principal's); Daniel Markovits, *Sharing Ex Ante and Sharing Ex Post: The Non-Contractual Basis of Fiduciary Relations*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 215 (quoting Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1049 (2011)) (explaining that fiduciary duties are necessary due to the potential for abuse inherent in the structure of agency relationships); Ribstein, *supra* note 7, at 232 (2005) (stating that fiduciary duties are justified where other devices for "controlling discretion" are likely to fail); Sitkoff, *supra* note 225, at 207 (explaining that the fiduciary duty, necessary to guard against abuse, is consistent with the agency model, or agency-cost model, of fiduciary relationships); Smith, *supra* note 198, at 263 (explaining that the justification of fiduciary law as countering opportunism is historically an outgrowth of equity).

290. See Weinrib, *supra* note 173, at 4, 7.

291. *Id.* at 4.

292. *Id.*

293. *Id.* Weinrib, like Miller and Smith, seeks to include advisors in fiduciary relationships. When referring to classic fiduciaries, he refers to an agent who bargains *or advises*, as opposed to a "middleman." *Id.* at 3-4. The former has a "leeway" for the exercise of judgment. *Id.* According to Weinrib, a principal necessarily does not control a fiduciary in any meaningful way. *Id.* at 4. As a result, the principal's interests can be affected by, and are dependent on, the fiduciary's exercise of discretion. *Id.* Weinrib then takes his analysis one step further and claims that fiduciary duties *only* arise when the fiduciary exercises discretion *and* the discretion can affect the principal's legal position. It is this last criterion that removes nondiscretionary advisors from Weinrib's criteria and makes the criteria inconsistent with the caselaw.

294. DeMott, *supra* note 33, at 915.

295. FRANKEL, *supra* note 31, at 108. Fiduciary relationships are hazardous to those who repose trust because fiduciaries can misappropriate entrusted property, fail to perform their services with care, or fail to follow the principal's directives. *Id.* at 26.

is then addressed by the fiduciary obligation.<sup>296</sup> The purposes for which a fiduciary is *permitted* to use delegated power, she writes, is narrower than the purposes for which he is *capable* of using that power.<sup>297</sup> As a result, the fiduciary can use the broad grant of power to benefit herself at the principal's expense. Fiduciary duties are a substitute for monitoring the fiduciary's exercise of her powers because monitoring can be expensive and onerous.<sup>298</sup>

The view that fiduciary duties are justified to control discretion is well-developed in the literature.<sup>299</sup> This justification is incomplete, however, because as shown in Part I, discretion is not a universal feature of fiduciary relationships. Fiduciary relationships arise in the context of advisors who lack discretion. The advisors discussed in Part I lack the ability to change the principal's legal or practical position. One might claim that these advisors have discretion in the loose sense that they exercise judgment when providing advice, but exercising judgment is not the same as possessing discretionary authority over a principal's assets or affairs. As a result, the justification for fiduciary duties cannot be limited to controlling discretionary authority. If controlling discretionary authority were the sole justification, there would be no reason to impose fiduciary duties on advisors who lack discretionary authority. There must be something else at stake, a better reason that justifies fiduciary duties for advisors. Part III provides the justification.

### III. JUSTIFYING ADVISORS' FIDUCIARY DUTIES

Part I explained that advisors, including advisors who exercise no discretionary authority over their clients' assets or affairs, are often considered fiduciaries. Part II then explained the implications of Part I for fiduciary theory, including the deficiencies of the discretionary authority approach and the drawback of viewing control over the fiduciary's discretion as the primary reason for imposing fiduciary duties.

This Part develops a justification for imposing a fiduciary duty on certain advisors. The justification is especially important with respect to advisors who are not otherwise considered fiduciaries. If an advisor is a status-based or "categorical" fiduciary (such as a trustee, partner, or lawyer), courts can impose fiduciary duties not specifically because of the advice given but rather because the advisor is generally deemed a fiduciary. The more difficult question I shall explore is why giving advice

296. Frankel, *supra* note 177, at 804.

297. *Id.* at 810.

298. See FRANKEL, *supra* note 31, at 29. More recently, Frankel writes that the assumption underlying fiduciary law is that the principal cannot protect himself against the potential for abuse. Tamar Frankel, *Watering Down Fiduciary Duties*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 3, at 242, 247.

299. See *supra* note 289 and accompanying text.

justifies imposing a fiduciary duty on an individual or firm not otherwise considered a fiduciary.

The primary argument is 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. Advisors seek to generate a relationship of trust with clients. Trust leads to clients' reliance on the advisor and to vulnerability with respect to matters related to the advice. An advisor's fiduciary duty arises from the nature of the relationship characterized by trust, reliance, and vulnerability. Imposing a fiduciary duty aims to prevent the harm that can befall a vulnerable client and, at the same time, it helps to promote a relationship through ensuring that the advisor is acting in the client's interest and not for some other reasons. Although trust may not necessarily be an essential component of all fiduciary relationships, it is an essential component of an advisory relationship—and the foundation of an advisor's fiduciary duty.<sup>300</sup>

Imposing a fiduciary duty is appropriate for many advisors. However, not every instance of advice giving will or should lead to fiduciary liability. It is fanciful to conclude that any and all advice offered by a stranger on a street corner should be considered advice subject to a fiduciary standard. There is a fine line between informal advice, which should not be the subject of liability, and advice that should be subject to legal redress. Thus, this Part also proposes guidance to help distinguish when certain advice giving should lead to fiduciary liability.

A significant amount of advice is given by advisors who are otherwise considered fiduciaries. Therefore, this Part begins with a short discussion of advice provided by status-based fiduciaries because norms that have developed for status-based fiduciary advisors may bear on other advisors as well. Next, this Part moves to the more difficult case of ad hoc fiduciary advisors and a discussion of trust, reliance, and vulnerability in advisory relationships. This Part concludes with proposed guidance to distinguish between informal advice giving and advice giving that creates a fiduciary relationship.

#### A. *Status-Based Fiduciary Advisors*

Certain individuals and firms have long been recognized as status-based or categorical fiduciaries; they are treated as fiduciaries as a matter of law based on their status.<sup>301</sup> Status-based fiduciaries include trustees, partners, corporate directors, lawyers, and others.<sup>302</sup> Their fiduciary status is well-accepted and seldom questioned. Once an individual becomes a trustee, for example, that person is considered a fiduciary

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300. See Gold, *supra* note 4, at 1.

301. Andrew S. Gold & Paul B. Miller, *Introduction to PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW*, *supra* note 3, at 1, 2.

302. *Id.* at 3.

when acting in her trustee capacity merely as a result of her status. There is no need to investigate whether a trustee is a fiduciary. The question is closed based on the convention of treating trustees as fiduciaries.

One reason for placing a fiduciary duty on certain advisors is that many individuals or firms that give advice are status-based fiduciaries. A significant component of the work of a trustee or lawyer, for example, is the provision of professional advice. Imposing fiduciary duties on these individuals includes imposing fiduciary duties in the context of their advice giving. Once one has determined that a professional is a status-based fiduciary, it would be odd to hold that she is not a fiduciary in her advice giving capacity, especially when the provision of advice, as we shall see, can raise many of the concerns that the fiduciary obligation is typically meant to address. As Julian Velasco writes, “[A]dvisers who belong to a class that is deemed fiduciary should be presumed to be fiduciaries.”<sup>303</sup> Courts impose fiduciary duties in categorical fiduciary relationships as a prophylactic measure, which takes into account the odds of potential abuse.<sup>304</sup>

The law applicable to status-based fiduciaries may also bear on the law applicable to ad hoc fiduciaries and on a client’s reasonable expectations with respect to an ad hoc fiduciary.<sup>305</sup> Courts often analyze whether someone is an ad hoc fiduciary against a backdrop dominated by status-based fiduciaries.<sup>306</sup> The law applicable to status-based fiduciary advisors may signal to other advisors what is expected of them.<sup>307</sup> In other words, to the extent that certain advisors are *always* considered fiduciaries, this result may lead other advisees to assume that advice giving, even if done by someone who is not a status-based fiduciary, is a fiduciary enterprise. If advice by one trusted professional, such as a trustee or a lawyer, is a fiduciary activity, clients may expect advice by another trusted professional to be a fiduciary activity as well.<sup>308</sup>

303. Velasco, *supra* note 3, at 90.

304. See Gold, *supra* note 4, at 10.

305. See Matthew Harding, *Fiduciary Law and Social Norms*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 11, at 798.

306. See Deborah A. DeMott, *Relationships of Trust and Confidence in the Workplace*, 100 CORNELL L. REV. 1255, 1265 (2015).

307. See Harding, *supra* note 201, at 72 (“One way in which fiduciary law supplies this guidance [regarding what is implied in a principal’s trust] is via its express recognition of certain relationship types as prima facie fiduciary in character; the relationships of trustee-beneficiary, agent-principal, solicitor-client, and partner-partner are often given in this connection.”).

308. Empirical evidence supports this expectation. SEC-registered investment advisors owe fiduciary duties to clients. U.S. SEC. & EXCH. COMM’N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 100 (2011). SEC-registered broker-dealers, who also provide advice, are not typically considered fiduciaries. *Id.* Yet most people believe that similar activity, namely the provision of investment advice, would result in the same standard of conduct. See *id.* at 99–100.

This spillover effect from status-based to ad hoc fiduciaries, however, might simply be an error in reasoning. Although it might bear on one's empirical expectations, it is not an independent reason to impose a fiduciary duty on advisors who are not status-based fiduciaries.<sup>309</sup> The next Section develops an argument for imposing a fiduciary duty on advisors who are not otherwise considered fiduciaries.

### B. *Ad Hoc Fiduciary Advisors*

This Section focuses on the person or firm that provides advice and that is not considered a status-based fiduciary, such as a bank, business advisor, or stockbroker discussed in Part I. A justification for imposing a fiduciary duty on these persons and firms is important because they are more likely to be unaware that they owe a fiduciary obligation.<sup>310</sup> The justification developed in this Section is based on advisors' roles and norms of advice giving that have developed over time. When certain individuals provide advice, they give advice in the context of a high level of trust. Trust is often a key component of an advisory relationship. This Section, drawing on social science literature, explains the connection between advice and trust. It then discusses the reliance, vulnerability, and potential abuse that can result from a relationship of trust and the protections that fiduciary duties afford.

#### 1. Advice and Trust

This Section first identifies the close relationship between advice and trust. Although advising is a complex phenomenon, certain general principles are common to most cases of advice giving. Trust is a similarly complex phenomenon. Social science literature closely links advice and trust, viewing advice giving as an invitation to a client to repose trust in an advisor. Moreover, viewing an advisor as occupying a role grounded in trust is consistent with one's intuitions about advice as well as with caselaw explored in this Article. If an advisor is not seeking another's trust, or is not at least acting as if she were seeking another's trust, then she is likely not engaged in advice giving.

##### a. Characteristics of Advice

Before describing the relationship between trust and advice, let us first clarify some key characteristics of advice. Advice is given in a wide array of professional and personal settings, including friendship, family,

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309. Laby, *supra* note 8, at 751–53.

310. See Gold, *supra* note 4, at 11.

healthcare, education, business, and law.<sup>311</sup> It is given in close, personal relationships, and in formal, institutional relationships.<sup>312</sup> Advice is studied in many disciplines, including communications, psychology, business, sociology, education, and medicine.<sup>313</sup> It is challenging, therefore, to draw broad generalizations about advice. But there are some well-accepted principles that are helpful in understanding the social context of advice giving.

In explaining what advice means and its importance, social scientists refer to *advice normativity*, the presentation of advice as a normative, appropriate, or beneficial action.<sup>314</sup> Advice is something that a recipient *should follow*.<sup>315</sup> John Heritage and Sue Sefi define advice as something that “describes, recommends, or otherwise forwards a preferred course of future action.”<sup>316</sup> This normative dimension, they argue, is central to the activity of advice giving.<sup>317</sup>

Erina MacGeorge and Lyn Van Swol synthesize the literature on advice giving and identify seven prototypical elements: (i) a focus on the client’s action; (ii) a focus on the future; (iii) the intention to guide the client’s future behavior; (iv) a one-on-one communication; (v) a disparity of expertise between advisor and client; (vi) the existence of a problem; and (vii) the intention to help resolve the problem.<sup>318</sup> According to MacGeorge and Van Swol, recommendations made strictly with ulterior motives, that lack utility, or that are harmful to an advisee, cannot be considered prototypical advice.<sup>319</sup> These criteria help clarify the social norms associated with advice: Advice should be shorn of ulterior motives (suggesting the injunction against conflicts of interest), and it must be useful and not harmful to the client (suggesting the need for diligence).<sup>320</sup> These norms presage the fiduciary duties of loyalty and care discussed below.

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311. Erina L. MacGeorge & Lyn M. Van Swol, *Advice Across Disciplines and Contexts*, in THE OXFORD HANDBOOK OF ADVICE 3, 4 (Erina L. MacGeorge & Lyn M. Van Swol eds., 2018).

312. Lisa Guntzviller, *Advice Messages and Interactions*, in THE OXFORD HANDBOOK OF ADVICE, *supra* note 311, at 69.

313. MacGeorge & Van Swol, *supra* note 311, at 4.

314. See Guntzviller, *supra* note 312, at 71.

315. *Id.*

316. John Heritage & Sue Sefi, *Dilemmas of Advice: Aspects of the Delivery and Reception of Advice in Interactions Between Health Visitors and First-Time Mothers*, in TALK AT WORK 359, 368 (Paul Drew & John Heritage eds., 1992); see also Chloe Shaw et al., *Advice-Implicative Actions: Using Interrogatives and Assessments to Deliver Advice in Mundane Conversation*, 17 DISCOURSE STUD. 317, 319 (2015) (adopting the definition of advice advanced by Heritage & Sefi); Guntzviller, *supra* note 312, at 71 (discussing “advice interactions”).

317. Heritage & Sefi, *supra* note 316, at 368.

318. MacGeorge & Van Swol, *supra* note 311, at 6–7.

319. *Id.* at 6.

320. See *id.* at 5–6.

MacGeorge and Van Swol’s analysis is consistent with standard definitions of advice. The Oxford English Dictionary defines “advise” as “[t]o give guidance or suggestions, or state one’s opinion, to (a person, etc.) as to the best course of action; to counsel, make recommendations to; (also more generally) to give one’s assessment of something to (a person), usually as a basis for making a decision.”<sup>321</sup> As I have explained elsewhere, the touchstone of this definition is the phrase “as to the best course of action” for the client.<sup>322</sup> Similarly, the word “recommend,” embedded in the definition above, means “[t]o mention or present (a thing, course of action) to . . . a person . . . as being desirable or advisable.”<sup>323</sup> Implicit is that the “thing” or “course of action” under consideration is “desirable” or “advisable” for the client. The client, however, often does not know whether the advice is desirable, especially if he lacks the advisor’s expertise. Thus, the next Section turns to the trust a client is asked to place in his advisor.

#### b. Trust as a Component of Advice

Trust, like advice, is complex and has a variety of meanings depending on context. Like advice, trust is studied in a variety of disciplines and defies generalizations.<sup>324</sup> Broadly conceived, “Trust is an attitude that recognizes and responds to the freedom of individuals to make choices.”<sup>325</sup> An advisor has the freedom to make advisory choices when advising a client, and trust is the client’s attitudinal response that such choices will benefit the client.<sup>326</sup> Consistent with that understanding,

321. *Advise*, OXFORD ENGLISH DICTIONARY (2020).

322. Laby, *supra* note 8, at 767.

323. *Recommend*, OXFORD ENGLISH DICTIONARY (2020) (emphasis omitted).

324. See T.K. Das & Bing-Sheng Teng, *The Risk-Based View of Trust: A Conceptual Framework*, 19 J. BUS. & PSYCH. 85, 86 (2004); Matthew Harding, *Manifesting Trust*, 29 OXFORD J. LEGAL STUD. 245, 246 (2009).

325. Harding, *supra* note 324, at 248; see also Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457, 1461 (2005) (stating that researchers have “accepted a definition of trust as a belief, attitude, or expectation . . . that the actions or outcomes of another individual . . . will be acceptable or will serve the actor’s interests” (quoting Sim B. Sitkin & Nancy L. Roth, *Explaining the Limited Effectiveness of Legalistic “Remedies” for Trust/Distrust*, 4 ORG. SCI. 367, 368 (1993))); Larry E. Ribstein, *Law v. Trust*, 81 B.U.L. REV. 553, 556 (2001) (“Trust can be seen simply as a *decision* by one person to give power over his person or property to another in exchange for a return promise.”).

326. The freedom to make advisory choices is not the same as the discretionary authority, which some view as necessary for a fiduciary duty to arise. As mentioned, if one defines “discretion” so capaciously to include *making advisory choices*, then this Article agrees that advisors have “discretion.” But that is not the definition of discretion employed by the writers discussed in Part II. It appears that certain trust theorists make the same mistake about discretion that many fiduciary theorists make. Certain trust theorists appear to insist that trust must entail discretion. Harding, *supra* note 324, at 253–54. However, this Article maintains that discretion is

another definition of trust is “a relationship in which one party reasonably believes that the other party is telling the truth and will meet its obligations.”<sup>327</sup> Moreover, the features of advice described by MacGeorge and Van Swol are characteristic of a trust relationship: close personal communications, a disparity of expertise, and one person who is meant to help another.<sup>328</sup> These definitions demonstrate that the social context of advice is one of trust.

Social scientists explore the interesting dynamic that occurs between trust and advice. The philosopher Edward S. Hinchman considers the act of advising a client as an *invitation* to the client to repose trust in the advisor.<sup>329</sup> As Hinchman explains, what makes advice different from other speech acts is that the advisor assumes a perspective that she is acting from a point of view to help the client, and she presumes to know as well or better than the client what is in the client’s interest.<sup>330</sup> As Hinchman writes, the advisor presents herself as “adopting a perspective on [the] advisee’s self-interest that rivals in authority for the advisee the advisee’s own perspective.”<sup>331</sup> An advisor invites the client to trust the advisor’s perspective regarding the client’s interests, even if that perspective conflicts with the client’s own perspective.<sup>332</sup>

Inviting the client to trust the advisor’s perspective to rival the client’s own perspective is necessary and appropriate in light of the disparity of information and expertise between most advisors and their clients. As Richard Brooks explains, certain fiduciaries acquire special knowledge about their principals.<sup>333</sup> An advisor often will be privy to private and personal information about a client.<sup>334</sup> Sometimes, a fiduciary may have

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not a necessary element of a trust relationship, just as it is not a necessary element of a fiduciary relationship.

327. MARK FAGAN & TAMAR FRANKEL, *TRUST AND HONESTY IN THE REAL WORLD* 3 (2d ed. 2009); see also Denise M. Rousseau et al., *Not So Different After All: A Cross-Discipline View of Trust*, 23 *ACAD. MGMT. REV.* 393, 399 (1998) (“Trust emerges when the trustor perceives that the trustee intends to perform an action that is beneficial.”).

328. See MacGeorge & Van Swol, *supra* note 311, at 6–7.

329. See Edward S. Hinchman, *Advising as Inviting to Trust*, 35 *CANADIAN J. PHIL.* 355, 356 (2005).

330. *Id.* at 358.

331. *Id.*

332. *Id.* at 359. Advice is not the only activity that invites trust. The act of promising arguably invites trust as well. By making a promise, the promisor invites another to trust that the promise will be kept and, by accepting the promise, the promisee also accepts trust. DORI KIMEL, *FROM PROMISE TO CONTRACT* 31 (2003). An important difference between advising and promising, however, is that the promisor does not assume a perspective where she presumes to know as well or better than the promisee what is in the promisee’s interest.

333. Richard R.W. Brooks, *Knowledge in Fiduciary Relations*, in *PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW*, *supra* note 3, at 225, 237–38.

334. *Id.*

even more knowledge about a principal than the principal has about himself.<sup>335</sup> Based on skill, experience, and expertise developed over years, an advisor, Brooks suggests, is likely to have a better understanding of how to put this knowledge to use in a way that will benefit the client.<sup>336</sup> The disparity described by Brooks is consistent with Hinchman's claim that an advisor invites the client to trust the advisor's perspective as rivaling the client's own perspective.

According to Hinchman's account then, trust serves as the foundation of advice. The presumption inherent in advice is that the advisor gives the client a reason to act (regardless of whether the client actually follows the advice) by virtue of the client's recognition that the advisor's reason for the client to act, and the eventual action by the client, is what the advisor intends.<sup>337</sup> When you advise another, "you invite him . . . to trust your perspective on what he should do: to treat it as a direct source of practical reasons, reasons grounded solely in your status as worthy of his trust."<sup>338</sup>

To further clarify the social context of advice, one can contrast the term "advise" with other speech acts that do not invite another to repose trust. To "convince" someone, for example, is "[t]o induce, prevail upon, persuade."<sup>339</sup> Nothing in the definition of "convince" suggests that the speaker invites another to trust, or that a relationship of trust will develop.<sup>340</sup> Similarly, to "persuade" means "[t]o urge successfully to do something; to attract, induce, or entice to something or in a particular direction."<sup>341</sup> To persuade suggests that the speaker is urging the recipient to move in a particular direction, but not necessarily in a direction that will help the recipient, which is a key element of advice. Although advice can be a form of persuasive communication, persuasion is not always motivated by the existence of a problem, and it does not necessarily betoken an intention to help the recipient. In fact, persuasion can represent an intention to benefit the persuader at the recipient's expense.<sup>342</sup> The terms "advise" and "persuade" may be interchangeable in colloquial speech (as in "I would like to *advise* you to repay the debt

335. *Id.* at 237.

336. *Id.* at 238; *see also* Amir N. Licht, *Motivation, Information, Negotiation: Why Fiduciary Accountability Cannot Be Negotiable*, in RESEARCH HANDBOOK ON FIDUCIARY LAW, *supra* note 3, at 169 ("The upshot is that fiduciary relations emerge as a legal regime in certain circumstances in order to regulate the power that stems from information asymmetries (coupled with self-interestedness).").

337. Hinchman, *supra* note 329, at 361.

338. *Id.*

339. *Convince*, OXFORD ENGLISH DICTIONARY (2020).

340. *Id.*

341. *Persuade*, OXFORD ENGLISH DICTIONARY (2020) (emphasis omitted).

342. MacGeorge & Van Swol, *supra* note 311, at 7.

you owe me!”), but such usage is sarcastic or satirical and inconsistent with the actual meaning of the terms.<sup>343</sup>

The understanding of an advisor’s role, as seeking to help another and inviting another to trust, conforms with one’s intuitions about advice. One might try to persuade or convince another to do something by giving reasons, which do not invoke trust, when one does not wish to help, and even when one seeks to thwart the other’s interests. A person might try to persuade or convince an adversary to act or refrain from acting in a manner related to the scope of their adversarial relationship. A competitor, for example, might seek to persuade her adversary from entering a competition. By contrast, it is nonsensical to speak of the competitor *advising* her adversary to refrain from entering (unless we are using the word sarcastically). It is nonsensical because the competitor does not intend to help her adversary and is not seeking her adversary’s trust.

Examples of an advisor’s trusted role are ubiquitous. When a career counselor advises a student, the counselor invites the student to trust her, and the student trusts that she will advise based on the student’s needs and not on some other criteria, such as what might be best for the school or for another student. When a librarian advises a patron on a book selection, the librarian invites the patron to trust her, and the patron trusts the librarian to advise based on what will be a good read for the patron, not based on the librarian’s friendship with an author, or another secret motive. Trust is a key component of advice.

It is instructive to look again at the cases discussed in Part I where advice is a trigger to transform a non-fiduciary relationship into a fiduciary relationship. Part I examined those cases to demonstrate, as a descriptive matter, that advisors are often fiduciaries, and that individuals and firms not typically considered fiduciaries can become fiduciaries when they act outside of their normal role and provide advice. A second look at those cases, from a normative perspective, demonstrates that trust is a key component of each advisory relationship.

Recall *In re Cendant Corp. Securities Litigation*, the auditor case. E&Y defended the case by arguing that auditors are not fiduciaries; Cendant replied that E&Y’s work extended to providing advice.<sup>344</sup> In examining the allegations that E&Y advised Cendant, the court stated that “[t]hese allegations are sufficient for Cendant to be able to demonstrate it reposed trust in E&Y’s superior skill and knowledge, specifically for the benefit of Cendant.”<sup>345</sup> The court recognized the close connection

343. See Hinchman, *supra* note 329, at 359 (explaining that one might use “advise” as a joke, as an effort at coercion, or as an effort at coercion masquerading as a joke).

344. *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 585, 608 (D.N.J. 2001).

345. *Id.* at 610.

between advice and trust, and ultimately to the possible imposition of fiduciary duties.

The same was true for *EBC I, Inc.*, the underwriting case. The complaint alleged that Goldman's client, eToys, relied on Goldman's advice and, therefore, Goldman acted in a fiduciary capacity.<sup>346</sup> In that case, the court focused on advice and explained that under the complaint, the parties allegedly created their own relationship of "higher trust" that went beyond a standard underwriting agreement and that required Goldman to deal honestly with eToys and disclose conflicts of interest.<sup>347</sup>

This Article is not suggesting that every advisory relationship is necessarily a relationship where a client subjectively reposes trust. (That is why the phrase "invitation to trust" is so apt.) One can imagine an advisory relationship between a lawyer and client, investment advisor and client, or doctor and patient where the client or patient follows the advice of a professional but does not subjectively trust her. The relationship, shorn of subjective trust, is still an advisory relationship. And it is well-accepted that trust is not an incident of every fiduciary relationship.<sup>348</sup> Providing advice, however, invites another to trust the advisor even if the advisee does not subjectively repose trust.<sup>349</sup>

Trust, then, is an important component of advice, and advice takes place in the context of a trust relationship, where the advisor seeks another's trust and confidence. If the advisor is not seeking another's trust, or is not acting as if she is seeking another's trust, her activity is something other than advice giving. Perhaps it is mere testimony, a command, or an attempt at persuasion. Consider the following example: If a traveler finds himself in a village far from home and asks for the nearest hotel, the simple answer is not advice. However, as soon as the villager adds, "But I would not stay there. I suggest a better hotel outside

346. *EBC I, Inc. v. Goldman, Sachs & Co.*, 832 N.E.2d 26, 30 (N.Y. 2005).

347. *Id.* at 32. The discretion theorist might point out that these examples—auditing and underwriting—entail discretion over the practical interests of another, even if not at the point where the fiduciary breach occurs. Putting aside the question of whether these services entailed discretion, the essential point is that advice giving, and the attendant trust reposed in the fiduciary, were the reasons the courts found a fiduciary relationship.

348. *See* Harding, *supra* note 201, at 65–66.

349. Trust is not all or nothing. Presumably, if a principal follows the advice of another, the principal has placed some amount of trust in the other, even if that trust is not complete. In that regard, this Article does not agree with Velasco's claim that advising is not susceptible to classification as fiduciary. Velasco, *supra* note 3, at 87–88. Velasco points out that advice is often conflicted or self-referential ("what I would do if I were you"), but one is willing to hear it to get another perspective. *Id.* at 87. This Article does not necessarily agree that most people expect advice to be conflicted. Even if some do, the perceived conflict may diminish the trust the advisee places in his advisor, but it does not eliminate it. Moreover, as discussed, conflicted advice is often grounds for a breach of fiduciary duty claim, thereby upholding an advisee's expectations that advice will not be conflicted. *See supra* Section I.B.

of town,” she is offering advice because she is inviting the traveler to trust her judgment, even if the advice does not give rise to fiduciary liability, which this Article discusses shortly. Before turning to the connection between trust and fiduciary duty, however, I first address the vulnerability that can arise when a client reposes trust in an advisor.

## 2. Trust and Vulnerability

Trust and vulnerability are cognate concepts. Most definitions of trust stress the acceptance of a vulnerable situation where one person, the trustor, believes that another person, the trustee, will care for the trustor’s interests.<sup>350</sup> A common definition of trust is “a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behavior of another.”<sup>351</sup> Similar definitions of trust are “a state involving confident positive expectations about another’s motives with respect to oneself in situations entailing risk”<sup>352</sup> and “the mutual confidence that one’s vulnerabilit[y] will not be exploited in an exchange.”<sup>353</sup> Vulnerability is the risk of loss or adverse outcome.<sup>354</sup> Risk is at the core of trust and there is wide agreement across disciplines that risk is the first of two essential conditions of trust.<sup>355</sup> The greater the level of vulnerability or risk that one faces, the greater the potential for trust.<sup>356</sup> According to some accounts, trust and vulnerability are inseparable—without vulnerability, there is no need for trust.<sup>357</sup>

For trust to reach its full potential, it must manifest in action. This manifestation can take several forms, such as allowing the trustee to perform tasks on the trustor’s behalf, providing personal or confidential information to the trustee, placing resources at the trustee’s disposal, or changing one’s position in accordance with the trustee’s views.<sup>358</sup> Trust characterized merely by attitudes or beliefs is not enough to benefit a

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350. Mark A. Hall, *Law, Medicine, and Trust*, 55 STAN. L. REV. 463, 474 (2002); Mark A. Hall et al., *Trust in Physicians and Medical Institutions: What Is It, Can It Be Measured, and Does It Matter?*, 79 MILBANK Q. 613, 615–16 (2001).

351. Rousseau et al., *supra* note 327, at 394–95 (emphasis omitted).

352. Susan D. Boon & John G. Holmes, *The Dynamics of Interpersonal Trust: Resolving Uncertainty in the Face of Risk*, in COOPERATION AND PROSOCIAL BEHAVIOR 190, 194 (Robert A. Hinde & Jo Groebel eds., 1991).

353. Jay B. Barney & Mark H. Hansen, *Trustworthiness as a Source of Competitive Advantage*, 15 STRATEGIC MGMT. J. 175, 177 (1994).

354. Das & Teng, *supra* note 324, at 104.

355. Rousseau et al., *supra* note 327, at 395.

356. Das & Teng, *supra* note 324, at 104; Hall, *supra* note 350, at 474; Hall et al., *supra* note 350, at 615.

357. *E.g.*, Hall et al., *supra* note 350, at 615.

358. *See* Das & Teng, *supra* note 324, at 103.

trustor.<sup>359</sup> When one person trusts another and acts on it, the first person gives the second the opportunity to show that the second person can be trusted.<sup>360</sup> The manifestation of trust played a key role in the cases discussed in Part I. In *Morris*, Morris placed his trust in American Bank. In *MidAmerica Federal Savings & Loan Ass'n*, MidAmerica placed its trust in Don Crow at Shearson. In *Cheng*, the Chengs placed confidence in William Grace at Merrill. In *EBC I, Inc.*, eToys trusted Goldman.

The manifestation of trust often takes the form of reliance. Many consider reliance, along with vulnerability, to be the second essential condition of trust.<sup>361</sup> One person relies on another to act in a way that will affect the first person's interest in a positive and meaningful way. Reliance is common in relationships with status-based fiduciaries. Clients rely on their lawyers, partners rely on one another, and trust beneficiaries rely on their trustees. Reliance is also common in other advisory relationships. Recall again some of the common characteristics of advice: a disparity of expertise between advisor and client and the intention to help with a problem. These characteristics describe a context in which clients rely on their advisors.

That said, not all trust relationships result in reliance. One might trust a friend or relative but not rely on her in a way that will affect one's personal interests. Perhaps one is confident that he *could* rely on her, but does not actually do so. Trust, however, often leads to reliance, and there is a fine line between the two. Many trusting relationships, including advisory relationships, can and do result in reliance, which is more likely to occur when a client lacks the specialized skills, knowledge, or education held by the advisor.

Once a client trusts and relies on an advisor, he becomes vulnerable to multiple forms of abuse. Two common forms of abuse are receiving conflicted advice and receiving ill-informed, incomplete, or erroneous advice. Advice might be conflicted in the sense that it is motivated by an advisor's self-interest or her interest in benefitting a third party, and the client may be unaware of the conflict. Or, perhaps *because* the client trusts that the advisor is looking after the client's interests, he believes it is unnecessary to inquire.<sup>362</sup> Even if advice is not conflicted, an advisor might not have undertaken the requisite amount of care and diligence in preparing the advice. As a result, the advice may be ill-considered, imprudent, or even reckless. Again, because the client has reposed trust in the advisor and relied on her to provide sound advice, the client may

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359. Harding, *supra* note 201, at 60.

360. *Id.* at 60–61.

361. See Rousseau et al., *supra* note 327, at 395.

362. The client may be afraid that posing the question will offend the advisor, especially if the relationship is a personal relationship.

be unaware that the advice is deficient.<sup>363</sup> Thus, although trust is generally thought of as positive, it has a dark side. Trust builds a relationship but, when abused, trust can also destroy a relationship. Trust and vulnerability highlight the need for fiduciary protections, as explained in the next Section.

### 3. The Need for Fiduciary Protections

The connection between trust and fiduciary duties has deep roots in both caselaw and fiduciary law scholarship. Deborah DeMott has surveyed dictionary definitions of the term “fiduciary” and concluded that a fiduciary, in layman’s terms, is someone who another should be able to trust to be loyal to the first person’s interests.<sup>364</sup> A relationship of trust as giving rise to fiduciary duties also appears in caselaw.<sup>365</sup> And many courts characterize fiduciary relationships as relationships of trust and confidence.<sup>366</sup>

The trust and reliance inherent in advisory relationships raise risks that are directly addressed by the fiduciary duties of loyalty and care. The duty

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363. In a glance back to Part II of this Article, note that the client can rely on the advisor, and be harmed as a result, even if the client does not give the advisor discretion over his affairs. If an advisee gives the advisor discretionary authority over his affairs, the potential for abuse may be even greater. However, as Part I demonstrates, discretion is not a necessary feature of an advisory relationship marked by trust and reliance.

364. DeMott, *supra* note 306, at 1259.

365. *See, e.g.*, Calvin Klein Trademark Tr. v. Wachner, 123 F. Supp. 2d 731, 734 (S.D.N.Y. 2000) (finding that a fiduciary relationship can arise “when one party’s superior position or superior access to confidential information is so great as virtually to require the other party to repose trust and confidence in the first party”); Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc., 767 F. Supp. 1220, 1231 (S.D.N.Y. 1991) (“Although the existence of fiduciary relationships under New York law cannot be determined by recourse to rigid formulas, New York courts typically focus on whether one person has reposed trust or confidence in another who thereby gains a resulting superiority or influence over the first.”), *rev’d on other grounds*, 967 F.2d 742 (2d Cir. 1992); Ed Schory & Sons, Inc. v. Soc’y Nat’l Bank, 662 N.E.2d 1074, 1081 (Ohio 1996) (defining a fiduciary relationship as one where one person reposes confidence and trust, and the other person acquires the resulting superiority or influence); *In re Estate of Beal*, 769 P.2d 150, 154 (Okla. 1989) (noting that a fiduciary relationship “exists whenever trust and confidence are placed by one person in the integrity and fidelity of another”); Wiener v. Lazard Freres & Co., 672 N.Y.S.2d 8, 14 (App. Div. 1998) (discussing that to determine whether a fiduciary relationship exists, “a court will look to whether a party reposed confidence in another and reasonably relied on the other’s superior expertise or knowledge”); Penato v. George, 383 N.Y.S.2d 900, 904 (App. Div. 1976) (“Broadly stated, a fiduciary relationship is one founded upon trust or confidence reposed by one person in the integrity and fidelity of another.”).

366. *See, e.g.*, Anderson v. ReconTrust Co., N.A., 407 P.3d 692, 697 (Mont. 2017) (“[A]n otherwise arms-length relationship between a lender and borrower or applicant may ripen into a fiduciary relationship ‘of trust and confidence,’ with attendant fiduciary duties . . . .”); TBF Fin., LLC v. Gregoire, 118 A.3d 511, 522 (Vt. 2015) (“The close relationship of trust and confidence necessary to establish a fiduciary relationship did not exist between the parties.”).

of loyalty, among other things, addresses conflicts of interest and helps ensure that an advisor acts in the advisee's interests as opposed to the advisor's interests or those of a third party. The duty of care helps ensure that an advisor is well-informed about the advisee and his circumstances and has undertaken the necessary diligence to advise in a way that will serve the advisee's interests. Let us briefly explore what these duties require before showing in more detail how they apply to advisors.

#### a. Negative and Positive Duties

In the American legal tradition, the fiduciary obligation consists of duties of loyalty and care.<sup>367</sup> Fiduciary relationships often risk two types of wrongdoing: conflicts of interest, misappropriation, and theft, which are addressed by the duty of loyalty; and neglect, indifference, and imprudence, which are addressed by the duty of care.<sup>368</sup> Thus, the duty of loyalty is primarily negative, and the duty of care primarily positive.<sup>369</sup>

The duty of loyalty prohibits a fiduciary from engaging in unauthorized harmful conduct.<sup>370</sup> Section 78 of the *Restatement (Third) of Trusts*, entitled Duty of Loyalty, is a good example. The tenor of this provision is negative and its prohibitions are absolute, in part because of the difficulty faced by a trustee in resisting temptation when personal interests conflict with duty.<sup>371</sup> The duty of loyalty prohibits a trustee from personally engaging in transactions with the trust, such as buying trust property, selling property to the trust, borrowing from or lending to the trust, or exchanging property with the trust.<sup>372</sup> Similarly, under corporate law, the duty of loyalty prohibits self-dealing transactions and misappropriation of corporate opportunities.<sup>373</sup> The duty of loyalty is implemented by preventative rules that address temptations faced by fiduciaries. These duties are negative.

367. See, e.g., *Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985); *Horras v. Am. Capital Strategies, Ltd.*, 729 F.3d 798, 802 (8th Cir. 2013); *CDX Liquidating Tr. v. Venrock Assocs.*, 640 F.3d 209, 215 (7th Cir. 2011); *In re Brook Valley VII, Joint Venture*, 496 F.3d 892, 900 (8th Cir. 2007).

368. Cooter & Freedman, *supra* note 37, at 1047.

369. For a more complete discussion, see Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U. L. REV. 75 (2004); *but see* *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 760 (Del. Ch. 2005) (citing Lyman P.Q. Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. LAW 27 (2003)).

370. See *Fiduciary Duties*, NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127, 129 (Peter Newman ed., 1998). For a more complete discussion of the proscriptionist approach to the fiduciary duty of loyalty, see Galoob & Leib, *supra* note 229, at 80–82.

371. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (AM. LAW INST. 2007).

372. *Id.* § 78 cmt. d.

373. *In re Shepps Food Stores, Inc.*, 160 B.R. 792, 797 (Bankr. S.D. Tex. 1993).

If the duty of loyalty is primarily negative, the duty of care is primarily positive. The *Restatement (Third) of Trusts* explains that the duty of care requires the trustee to use “reasonable effort and diligence” in planning the administration of the trust, making and implementing administrative decisions, and monitoring the trust.<sup>374</sup> The duty of care entails conducting an appropriate investigation and obtaining information about the contents of the trust estate and the circumstances of the trust and its beneficiaries.<sup>375</sup> In corporate law, the duty of care requires a director to exercise the degree of care and diligence that an ordinarily prudent person would exercise under similar circumstances.<sup>376</sup> A failure to sufficiently explore or evaluate alternative transactions, for example, implicates care, not loyalty.<sup>377</sup> As certain writers acknowledge, the point of entering into a fiduciary relationship is for the fiduciary to take initiative on the principal’s behalf.<sup>378</sup> A principal, according to Daniel Markovits, engages the fiduciary expressly because the principal is unable to handle affairs through standard contracts.<sup>379</sup> In this sense, Markovits explains, the principal effectively “*buys her fiduciary’s initiative*.”<sup>380</sup> Similarly, Julian Velasco explains that what the beneficiary wants most of all is for the fiduciary to “do[] a good job”—using her skill and diligence to further the principal’s interests.<sup>381</sup>

374. RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (AM. LAW INST. 2007).

375. *Id.* § 77 cmt. b.

376. *In re Shepps Food Stores, Inc.*, 160 B.R. at 797.

377. *See In re BJ’s Wholesale Club, Inc. S’holders Litig.*, No. 6623-VCN, 2013 WL 396202, at \*7 (Del. Ch. Jan. 31, 2013); *In re Alloy, Inc. S’holder Litig.*, No. 5626-VCP, 2011 WL 4863716, at \*8 (Del. Ch. Oct. 13, 2011).

378. *E.g.*, Markovits, *supra* note 289, at 216.

379. *Id.*

380. *Id.*

381. Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 690 (2015). According to some courts and commentators, the duty of care ranks as less important than the duty of loyalty, or is not a fiduciary duty at all. CONAGLEN, *supra* note 168, at 1, 17. Common law countries outside the United States generally do not view the duty of care as a fiduciary duty. Christopher M. Bruner, *Is the Corporate Director’s Duty of Care a “Fiduciary” Duty? Does It Matter?*, 48 WAKE FOREST L. REV. 1027, 1028 (2013). In Australia, for example, not all of a fiduciary’s duties are considered fiduciary duties, and a fiduciary’s obligations to exercise the level of care required of an ordinarily prudent person under the circumstances is not a fiduciary obligation. *Breen v. Williams* (1996) 186 CLR 71 (Austl.); *see* CONAGLEN, *supra* note 168, at 17–18. The same is true in the United Kingdom. *See Bristol & W. Bldg. Soc’y v. Mothew*, [1998] Ch. 1, at 16 (Eng.). Matthew Conaglen writes that it is well-established that loyalty is the “core” concept of the fiduciary obligation—the “defining” concept of fiduciary duty. CONAGLEN, *supra* note 168, at 1. Joshua Getzler states that while affirmative acts form part of the constellation of fiduciary duties, influential decisions of appellate courts outside of the United States hold that there are no affirmative fiduciary duties at all. Getzler, *supra* note 33, at 42. Even in the United States, some view the fiduciary duty of care as not central to the fiduciary obligation. *See, e.g.*, DeMott, *supra* note 33, at 915 (stating that the duty of care “is not distinctively fiduciary; many

### b. Justifying the Advisor's Fiduciary Duty

Understanding that the fiduciary duty has both negative and positive components helps explain how the fiduciary obligation protects and promotes advisory relationships. The previous Section argued that the intent of an advisor's fiduciary duty cannot be merely to curb the abuses attendant to discretionary authority because many advisors lack such authority. What purpose, then, is served by imposing a fiduciary duty on advisors? The advisor's fiduciary duty prohibits or limits some actions to protect advisory clients, and it requires other actions to help ensure that the advisor will do what the client desires most: provide sound advice in the client's best interest.

This Section begins with the duty of loyalty, which protects advisory clients from conflicts of interest and other forms of abuse. Abuse in an advisory relationship can take many forms. A primary concern is that an advisor will provide conflicted advice or will appropriate, or attempt to appropriate, a benefit for herself that should belong to the advisee.<sup>382</sup> A financial advisor, for example, may recommend an investment in a mediocre business owned or controlled by that advisor herself (or a friend or family member), instead of recommending the best possible investment. A lawyer may provide compromised legal advice through an undisclosed conflict or the receipt of undisclosed benefits.<sup>383</sup> A partner may advise other partners to follow a suboptimal course of conduct that will provide a secret benefit to himself or a third party. As Andrew Gold points out, a conflict of interest is a unique source of vulnerability that is different from the vulnerability that arises when one is subject to another's discretion.<sup>384</sup> The fiduciary duty of loyalty punishes this type of misconduct in advisory relationships; it deters the advisor from giving conflicted advice, obtaining an unauthorized benefit, or otherwise acting in one's self-interest when giving advice.<sup>385</sup>

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persons, by virtue of the law or their own contractual undertakings, owe duties of care to other persons with whom they have nonfiduciary relationships"). This Article disagrees with this account of the duty of care and ranks it as important as the duty of loyalty. The duty of care has a different quality, but it is a necessary element to help ensure that the fiduciary acts in the principal's best interest.

382. The risk of conflicted advice does not arise solely from the exercise of discretionary authority. An advisor with conflicted motivations can betray a client and abuse his trust. DeMott, *supra* note 306, at 1259–60; Harding, *supra* note 201, at 70.

383. See Flannigan, *supra* note 235, at 38–39.

384. See Gold, *supra* note 4, at 2.

385. See FRANKEL, *supra* note 31, at 272; see also *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992) ("The ward, the client, is in no position to supervise or control the actions of his principal on his behalf; he must take those actions on trust; the fiduciary principle is designed to prevent that trust from being misplaced.").

Disclosures of conflicts of interest play an important role here. J.E. Penner explains that advisors owe a duty to disclose an interest in the subject matter of the advice.<sup>386</sup> Disclosure causes, or may cause, the advisee to judge the advice differently—and perhaps refuse to follow it—because of the chance that the advisor’s judgment in applying her expertise was compromised.<sup>387</sup> Thus, a failure to disclose a conflict taints the advice and results in liability for losses the advisee incurs if he follows the course of action.

In the cases discussed in Part I, an advisor was tempted to recommend a course of action that is profitable for the advisor but not necessarily in the client’s best interest. In *Buxcel*, First Fidelity advised the Buxcels to buy the Fabers’ grocery store so that the Fabers would be able to repay their bank loan. In *Morris*, American Bank’s Young advised Morris to pay Wood out of her pocket and borrow from American Bank, which allowed Wood to repay his delinquent debts to the bank. In *Capital Gains*, the firm advised clients to buy certain securities without disclosing that the firm was profiting from a run-up in the price of the recommended securities. In *EBC I*, Goldman advised eToys to underprice its IPO shares because Goldman would benefit when other Goldman customers sold their IPO shares and paid Goldman a share of their profits. The fiduciary duty of loyalty prohibits precisely this kind of conflicted advice.

Minimizing an advisor’s harmful conduct, such as giving conflicted advice, through application of the duty of loyalty is one reason to impose a fiduciary obligation. An advisor might also take advantage of a client’s trust by shirking—neglecting her responsibilities to act consistently with the level of care and diligence required under the circumstances. The duty of care punishes shirking by requiring an advisor to exercise the degree of care that an ordinarily prudent person would exercise under similar circumstances.<sup>388</sup> The duty of care helps ensure that an advisor will take the positive steps necessary to give sound advice. It is not enough for the advisor to act disinterestedly; the duty of care helps ensure that she acts with diligence and prudence. As I have explained elsewhere, the twin duties of loyalty and care work together to require that some action be taken on the principal’s behalf while prohibiting these actions from being self-interested.<sup>389</sup>

In addition to viewing an advisor’s fiduciary duty as guarding against abuse, an advisor’s fiduciary duty also serves to promote advisory relationships by signaling to a client that the advisor will abide by a

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386. Penner, *supra* note 243, at \*13.

387. *Id.*

388. FRANKEL, *supra* note 31, at 181.

389. See Arthur B. Laby, *Juridical and Ethical Aspects of the Fiduciary Obligation*, 13 JAHRBUCH FÜR RECHT UND ETHIK 565, 582 (2005).

heightened standard of conduct. By assuming a strict fiduciary duty, the advisor enhances her credibility when inviting the client to trust in the manner described by Hinchman.<sup>390</sup> The duties of loyalty and care give a client, who may be reluctant to repose trust, the assurance that the fiduciary will not act in an abusive manner, either by harming the principal through giving conflicting advice, or by failing to provide advice that is the product of care and diligence. Although one might view fiduciary law as a substitute for the trustworthiness of fiduciaries, fiduciary law rather serves as a reason to repose trust and enter into an advisory relationship.<sup>391</sup> In this sense, fiduciary duties can promote and enhance trust and reliance that otherwise might be missing from an advisory relationship and facilitate advice giving.<sup>392</sup>

Viewing fiduciary law from this perspective explains why certain advisor groups voluntarily choose to assume greater duties and responsibilities than the law would otherwise require.<sup>393</sup> Although this signaling may reflect a desire to build business, the means to achieving this end is building trust.

### C. *Distinguishing Fiduciary from Non-Fiduciary Advisors*

Not every nugget of informal advice, even where one might invite another's trust, creates, or even should create, a fiduciary relationship. Such widespread application of fiduciary principles would dilute fiduciary law and make informal relationships overly legalistic. Caselaw is clear that not all advice, even when one party has superior knowledge and attempts to profit from trust reposed, will result in fiduciary liability.<sup>394</sup> However, when certain advisors offer advice, a client will have a reasonable expectation that the advisor will act in a fiduciary capacity.<sup>395</sup> In what circumstances should one conclude that an advisee should have a reasonable expectation that the advisor will act as a

390. See Hinchman, *supra* note 329, at 358–60; see also Harding, *supra* note 201, at 64 (“By assuming a role that entails commitment to norms of selflessness, a fiduciary may invite her principal to trust that she (the fiduciary) will abide by those norms simply on the basis that the fiduciary occupies the role in question and role-occupants, generally speaking, can be trusted to abide by the norms entailed in that role.”).

391. See Harding, *supra* note 201, at 64 & n.23.

392. *Id.* at 62–63.

393. See, e.g., CFP BD., CODE OF ETHICS AND STANDARDS OF CONDUCT 3 (2018) (“CFP Board’s Code of *Ethics and Standards of Conduct* reflects the commitment that all CFP® professionals make to high standards of competency and ethics.”).

394. See *Comm. on Children’s Television, Inc. v. Gen. Foods Corp.*, 673 P.2d 660, 675 (Cal. 1983) (“[T]he efforts of commercial sellers—even those with superior bargaining power—to profit from the trust of consumers is not enough to create fiduciary duty.”).

395. See *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6, 57–58 (Austl.).

fiduciary? If advice does not always result in fiduciary liability, where should one draw the line?

It might be best to start with an example. Let us return to the traveler in need of lodging for the night. The traveler is looking for a clean, comfortable hotel. During dinner at a local restaurant, the server recommends the Garden Hotel, which is neither clean nor comfortable, but the server receives a small payment from the Garden Hotel when he refers customers and they book a room. These facts are unlikely to result in a breach of fiduciary duty—although one might say that the server invites the traveler to trust him, and the traveler expects that the referral is in his best interest and not based on a referral fee. Why does the advice in this hypothetical likely not result in fiduciary liability, and when should fiduciary liability be imposed on those offering advice?

There is no single answer to this question and decisions in some cases might seem arbitrary.<sup>396</sup> Courts appear to look to when advisors behave in such a way to lead advisees to have a reasonable expectation of fiduciary liability. Such expectations are a product of various social and economic factors viewed in the context of the advisory relationship.<sup>397</sup> They are more a matter of social customs and norms that develop over time than rigid criteria that can be repeatedly applied.

A classic case is *Burdett v. Miller*,<sup>398</sup> where Judge Richard Posner had to rule on whether an accountant, who also gave investment advice, was subject to a fiduciary standard. In *Burdett*, Robert Miller, an accountant, befriended Patricia Burdett when she took an accounting class he taught.<sup>399</sup> Burdett subsequently hired Miller to prepare her tax returns, and she later asked him for help with investing.<sup>400</sup> Miller advised her to invest in a series of ventures that were rife with conflicts of interest on Miller's part.<sup>401</sup> When the investments collapsed, Burdett sued Miller for breach of fiduciary duty.<sup>402</sup> In his opinion, Judge Posner noted that Miller lacked discretion over Burdett's assets.<sup>403</sup> Judge Posner, however, examined Miller's role in the relationship and concluded he was a

396. See Velasco, *supra* note 3, at 88 (stating that, in terms of fiduciary status, “[t]here is no obvious way to include some but not all advisers in a definitional or purely logical manner”).

397. See, e.g., *Stewart v. Phx. Nat’l Bank*, 64 P.2d 101, 106 (Ariz. 1937) (“[F]or some twenty-three years the plaintiff was not only a customer of the bank, but its officers and directors had been his financial advisors; that he had been told repeatedly of their friendship for him and had relied upon their advice; and that by reason of such relations he believed they would take no financial advantage of him.”).

398. 957 F.2d 1375 (7th Cir. 1992).

399. *Id.* at 1378–79.

400. *Id.* at 1379.

401. *Id.*

402. *Id.* at 1378–79.

403. *Id.* at 1381.

fiduciary.<sup>404</sup> Miller was sophisticated; Burdett was unsophisticated.<sup>405</sup> Miller cultivated a relationship of trust with Burdett and held himself out as an expert in investing.<sup>406</sup> Miller invited her to accept his advice and rely on his professional and professorial status.<sup>407</sup> Based on these considerations, it was reasonable for Burdett to expect that Miller would look out for her interests and act in a fiduciary capacity.

Reflecting on the social and economic context of advisory relationships, several factors might give rise to an expectation of fiduciary status by an advisor. This Section identifies three such factors, drawn from relevant statutes or common law doctrines, and explains why they are meaningful. The factors are the following: (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. This Section presents these considerations as candidates to help determine whether to impose a fiduciary duty on an advisor—not as a rigid three-part test.

*Holding out.* The most important of the three considerations is how one holds herself out, or represents herself, to others. The more that a speaker represents herself as someone who will provide expert advice, the more appropriate it is to hold the speaker to a fiduciary standard. Several legal doctrines rest on the principle that leading others to believe something about an actor can ground liability.<sup>408</sup> Under the doctrine of apparent agency, for example, an agent has authority to act on a principal's behalf when the principal's manifestations lead a third party to reasonably believe the agent has such authority.<sup>409</sup> The principal, under apparent agency, must hold out another as the principal's agent, and the injured party must rely on the agent's care or skill.<sup>410</sup> Holding out the agent as acting for the principal will result in the principal's liability.<sup>411</sup> Under the lesser known doctrine of estoppel by holding out, a person who permits himself to be held out as a partner in a business is estopped from

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404. *Id.* at 1382.

405. *Id.* at 1378.

406. *Id.* at 1382 (“[Miller acted] to invite her to accept his advice with no questions asked or answered, in reliance on his professional and professorial status, on his insight into the arcana of tax shelter investments—a technical area about which she was ignorant—and on a continuing business relationship shading into a social friendship.”).

407. *Id.*

408. See Deborah A. DeMott, *The Poseur as Agent*, in AGENCY LAW IN COMMERCIAL PRACTICE 35, 35 (Danny Busch et al. eds., 2016).

409. RESTATEMENT (THIRD) OF AGENCY § 2.03 (AM. LAW INST. 2006).

410. See, e.g., *Eads v. Borman*, 227 P.3d 826, 830–31 (Or. Ct. App. 2010), *aff'd*, 351 Or. 729 (2012).

411. *Id.* at 831.

denying association with the partnership and will be bound by its contracts.<sup>412</sup>

In determining whether a stockbroker is subject to a fiduciary standard, the SEC looks to whether the broker holds herself out as providing confidential advisory services and represents that she will act in a customer's interest.<sup>413</sup> Moreover, federal investment advisor law exempts certain advisors from an SEC registration requirement as long as they do not hold themselves out as investment advisors and meet other requirements.<sup>414</sup> To determine fiduciary status, Australian law looks to whether one has held herself out as having expertise in advising.<sup>415</sup> There is no doubt that how one holds oneself out to another is meant to, and will, have a direct bearing on the second person's expectations with regard to the first.

*Primary role.* When the provision of advice is a central focus of a relationship between an advisor and advisee, especially when the advisor is acting in a professional capacity, it is reasonable to expect the advisor to give advice that is in the advisee's best interest. By contrast, if advice is provided as an afterthought or is merely incidental to another activity, the advisor is not representing herself in the same way, and the advisee's expectations would adapt accordingly.

Certain individuals, such as lawyers and investment advisors, are in the advice business. Advising is the heart of their work. Most clients would not consider hiring a professional, such as a lawyer or investment advisor, if her advice were unsound. That is not the case for other professionals who occasionally dispense advice but doing so is not their primary function. One's expectations with regard to these other professionals are not the same.

A banker is a good example of the latter category. Although financial institutions often provide advice in the context of making a loan, advising is not a bank's primary role. A bank's primary business is lending, not advising, and banks typically are not considered fiduciaries. When a customer's relationship with a bank is one where advice predominates, however, a court is likely to rule that the bank is a fiduciary. In *Buxcel*, for example, advice was essential to the bank's role with respect to the Buxcels. The bank encouraged them to take out the SBA loan. It

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412. *Antoskow & Assocs., LLC v. Gregory*, 629 S.E.2d 1, 4 (Ga. Ct. App. 2005); *Time Fin. Servs., Inc. v. Hewitt*, 228 S.E.2d 176, 178 (Ga. Ct. App. 1976).

413. *Hughes*, Exchange Act Release No. 4048, 27 SEC Docket 629 (Feb. 18, 1948).

414. Investment Advisers Act of 1940 § 202(a)(30), 15 U.S.C. § 80b-2(a)(30) (2018).

415. *See Daly v. Sydney Stock Exch Ltd* (1986) 160 CLR 371 (Austl.) ("Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises.").

assembled their financial package and advised them to proceed, forming a fiduciary relationship.<sup>416</sup>

A determination of whether advice is a central focus of a relationship is a facts-and-circumstances test. In making this determination, one might consider the following additional considerations: (1) an individual's professional training and development or, in the case of a firm, the firm's historical development; (2) public representations of the individual or firm regarding its line of work; (3) an individual's day-to-day activities or, if a firm, the activities of its officers and directors; (4) the purpose of the primary expenditures of the person or firm—how it spends its money; and (5) the person or firm's source of income.<sup>417</sup> This last factor—source of income—should weigh more heavily than the others for reasons explained next.

*Compensation.* A person's compensation bears on how customers and clients are likely to perceive that person, and it bears on reasonable expectations with regard to the person. Empirical literature demonstrates that people are more receptive to advice when it costs money than when it is free.<sup>418</sup> If an advisee pays for advice, he is likely to take the advice

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416. *See supra* notes 42–51 and accompanying text. The IAA codifies the primary activity thesis to determine when certain professionals would be considered investment advisors and subject to fiduciary duties. Under the IAA, certain professionals—lawyers, accountants, engineers, teachers, and brokers—are excluded from the definition of investment advisor as long as their advisory activity is “solely incidental” to their other professional conduct. Investment Advisers Act of 1940 § 202(a)(11)(B), (C), 15 U.S.C. § 80b-2(a)(11)(B), (C). In the case of broker-dealers, a second condition is that the broker must “receive[] no special compensation” for providing advice. 15 U.S.C. § 80b-2(a)(11)(C); *see also* Zinn v. Parrish, 644 F.2d 360, 364 (7th Cir. 1981) (holding that a lawyer making “isolated transactions with a client as an incident to the main purpose of [a] management contract” did not render the lawyer an investment advisor); Sullivan v. Chase Inv. Serv. of Bos., Inc., 434 F. Supp. 171, 188 (N.D. Cal. 1977) (holding that a lawyer is not considered an investment advisor if the lawyer, in the usual course of his normal duties, also counsels a client as to the advisability of buying or selling securities); Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, 52 Fed. Reg. 38,400, 38,403 (Oct. 16, 1987) (to be codified at 17 C.F.R. pt. 276) (reiterating and clarifying the standards in the Investment Advisers Act of 1940 § 202(a)(11)(B), (C)).

417. These factors are based in part on *In re Tonopah Mining Co. of Nev.*, Investment Company Act Release No. 12712, 26 SEC Docket 426 (1947), where the SEC had to determine whether a company was “primarily engaged” in a business other than investing, so as to make the company eligible for relief from the Investment Company Act of 1940. *See also* SEC v. Fifth Ave. Coach Lines, Inc., 289 F. Supp. 3, 29 (S.D.N.Y. 1968) (applying the factor test to determine what business the defendant was “primarily engaged in”).

418. *See* Francesca Gino, *Do We Listen to Advice Just Because We Paid for It? The Impact of Advice Cost on Its Use*, 107 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 234, 243 (2008) (“The results of the studies show that participants relied more heavily on advice when it cost money than when it was free.”); Anthony G. Patt et al., *Mechanisms for Enhancing the Credibility of an Adviser: Prepayment and Aligned Incentives*, 19 J. BEHAV. DECISION MAKING 347, 356 (2006) (“Participants who had the opportunity to purchase advice were significantly

more seriously, and it is reasonable for the advisee to expect that the advice is in his best interest. Why else would the advisee pay so dearly?

Like the primary role inquiry, a focus on compensation was codified in the test to determine when certain professionals are considered investment advisors and therefore subject to a fiduciary standard. The IAA excludes stockbrokers who give advice to their customers from the definition of “adviser” but only insofar that they do not receive “special compensation” for providing advice and meet other conditions.<sup>419</sup> Receipt of compensation for providing advice vitiates application of the broker-dealer exclusion from the IAA, and subjects a broker who gives advice to a fiduciary duty applicable to investment advisors.<sup>420</sup>

With these three considerations—holding out, primary role, and compensation—in mind, consider the difficult case of an automobile mechanic, or another skilled worker, who provides advice as part of the services rendered. Why should the automobile mechanic not be considered a fiduciary?<sup>421</sup> A mechanic will diagnose the problem with a customer’s car and provide advice or recommendations on how to address it. Then, if the customer agrees, the mechanic will make the needed repairs. Notwithstanding the advice provided, mechanics are not fiduciaries.<sup>422</sup> Before explaining why this outcome is consistent with my approach, let us briefly explore the relevant arguments.

Richard Nolan asks why a car mechanic is not a fiduciary given her power to affect a customer’s interests and the disparity of information

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more likely to follow their advisers’ suggestions than were participants who received free advice . . .”).

419. 15 U.S.C. § 80b-2(a)(11)(C).

420. This Article recognizes that, in many cases, determining whether advice is central to a relationship and parsing an advisor’s sources of compensation will be difficult. The needed information for such determinations is often not transparent. A bank customer, for example, might not be aware of a bank officer’s role; nor is the customer made aware of the employee’s pay structure. Wells Fargo customers did not know of the intense pressures the bank placed on its employees to open new bank accounts and engage in cross-selling. See Emily Glazer, *How Wells Fargo’s High-Pressure Sales Culture Spiraled Out of Control*, WALL ST. J. (Sept. 16, 2016, 3:10 PM), <https://www.wsj.com/articles/how-wells-fargos-high-pressure-sales-culture-spiraled-out-of-control-1474053044> [<https://perma.cc/7AZS-78TR>]. Moreover, a professional might obscure these facts to convey a false impression that the professional is working in the client’s best interest when he is not. The factors above might help determine retrospectively when an individual or firm was holding itself out as a fiduciary advisor but not actually acting in the client’s best interest. In those cases, fiduciary liability would ensue.

421. See Flannigan, *supra* note 235, at 28–36.

422. See *Int’l Ins. Co. v. Certain Underwriters at Lloyd’s London*, No. 88 C 9838, 1991 WL 349914 at \*9 (N.D. Ill. Sept. 16, 1991) (“[A]utomobile mechanics or termite inspectors are not normally considered fiduciaries of their clients, though they owe them a duty of honesty and care.”); *Thompson v. Wis. Cty. Mut. Ins. Corp.*, No. 95-3107-FT, 1996 WL 330363 at \*1 (Wis. Ct. App. June 18, 1996) (“An auto mechanic’s services occasion no fiduciary-like trust or equivalent reposing of faith.”).

between a mechanic and a customer.<sup>423</sup> Nolan's answer seems to be that a fiduciary duty is not necessary for a mechanic because a customer can control a mechanic's actions through specific contractual duties to perform a discrete task.<sup>424</sup> One can specify constraints on the mechanic's conduct *ex ante*. By contrast, it is difficult to specify the necessary conduct for a trustee or company director due to the manifold ways in which they can perform their tasks.<sup>425</sup>

Robert Flannigan disagrees. Flannigan writes that ease of contracting as an explanation for denying fiduciary accountability is erroneous and does not reflect the relevant jurisprudence.<sup>426</sup> Flannigan points to the risk of opportunism as a reason to impose fiduciary liability on mechanics.<sup>427</sup> A mechanic might use a vehicle for improper purposes, such as transporting other customers or running errands, or she might strip the vehicle of expensive parts and substitute cheaper ones.<sup>428</sup>

Leonard Rotman addresses this issue as well. Like Flannigan, Rotman states that the mechanic has power over a customer, and the customer becomes vulnerable to the mechanic's abuse of power.<sup>429</sup> Vulnerability to abuse might necessitate fiduciary protection.<sup>430</sup> In the end, Rotman disagrees that mechanics are fiduciaries, writing that the relationship with a customer lacks a sufficient degree of trust and confidence to merit fiduciary protections.<sup>431</sup> This Article agrees with Rotman, but not necessarily with his reasoning.<sup>432</sup>

Nolan's view is closer to mine, but the analysis relates to this Article's test of inquiring into the individual's primary role. A customer typically does not hire a car mechanic primarily for advice. Instead, a customer hires a mechanic to repair the vehicle and, as Nolan indicates, contracting for a repair is more easily accomplished. Like a plumber, roofer, carpenter, or other skilled worker, the mechanic's primary responsibility is to complete a successful repair. It is true that providing advice may be one aspect of the services provided. And many customers may demand a diagnosis of the problem and an assessment of whether the promised

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423. Richard C. Nolan, *The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report*, 6 THEORETICAL INQUIRIES L. 413, 422 (2005).

424. *See id.*

425. *Id.* at 422–23.

426. Flannigan, *supra* note 235, at 31.

427. *Id.*

428. *Id.*

429. LEONARD I. ROTMAN, FIDUCIARY LAW 252 (2005).

430. *Id.*

431. *Id.* at 252–53.

432. Rotman may be right that a customer and mechanic maintain an insufficient level of trust to support a fiduciary relationship. If a customer leaves his car with a mechanic for diagnosis and repair, however, then typically the customer is placing some level of trust in the mechanic.

repair will be effective before acceding to the work. But few automobile owners are interested primarily in advice—the goal is a working automobile.

In addition, the automobile mechanic typically does not hold herself out as an advisor. Automobile mechanics offer car maintenance, auto services, and auto repairs. It is nonsensical to think of automobile mechanics as offering advisory services with respect to the customer's automobile. Thus, under the first two considerations, mechanics are not fiduciaries.

Compensation is relevant as well. From the customer's perspective, payment to the automobile mechanic is primarily for repairs. From the mechanic's perspective, the customer is likely paying for both advice and repairs (and the cost of repairs will include the time it takes to diagnose the problem). From the customer's perspective, however, the compensation is not primarily for advice. One might analogize the mechanic to a stockbroker paid on commission, where fiduciary law is clearer. A broker provides advice and executes trades on a customer's behalf. The customer pays a commission on each trade, and commission pricing builds in compensation for advice incidental to brokerage. From the customer's perspective, however, he is paying for trade execution, not for advice. As this Article discusses, brokers are not considered fiduciaries unless special circumstances transform a standard brokerage relationship into a fiduciary relationship.<sup>433</sup> Thus, under the third consideration above, mechanics should not be considered fiduciaries.

Before concluding, one can return to some of the other examples referenced earlier. Take the traveler who received conflicted advice on where to spend the night. The restaurant server did not hold herself out as an expert advisor, her primary role was serving food and drinks, not providing advice, and the traveler did not pay for the advice. The same can be said of the librarian. Librarians serve many roles, including research, cataloging, and programming. But they do not hold themselves out as advisors; advice giving is not their primary function, and they typically are not paid specifically for giving advice. Thus, one would not expect fiduciary liability in these cases.

One can contrast these examples with leading cases determining when to impose a fiduciary duty on an advisor. In the case of *Burdett v. Miller* discussed above, each of the three proposed considerations was relevant to the court. Judge Posner wrote that Miller held himself out as an expert in the field of investments, in which Burdett was unsophisticated.<sup>434</sup> Miller's role transformed from one of accountant to one of advisor—he

433. See *supra* notes 81–97 and accompanying text.

434. *Burdett v. Miller*, 957 F.2d 1375, 1381 (7th Cir. 1992).

advised Burdett over a two-year period to invest in a series of ventures and even sold Burdett his own shares in one of those ventures.<sup>435</sup> And Burdett paid Miller professional fees; this was not merely a social relationship.<sup>436</sup> Based on these factors, it was reasonable for Burdett to expect that Miller would look out for her interests and act in a fiduciary capacity.<sup>437</sup>

This Part demonstrates that advisors should be fiduciaries not because they have discretion over the assets or affairs of their clients—because they often do not—but rather because of trust that advisors seek from their clients, and the resulting reliance and vulnerability that accompany reposing trust in another. Advice and trust are complex concepts, but one can view advice giving as an invitation to a client to repose trust in an advisor. Trust is commonly associated with reliance and vulnerability, and the fiduciary duties of loyalty and care both protect and promote the advisory relationship. Finally, this Part addresses how one might determine which advisors are subject to a fiduciary obligation. Recall that the *Restatement (Second) of Torts* provides that one who gives advice for the benefit of another is a fiduciary.<sup>438</sup> Not everyone who gives advice, however, should be held to a fiduciary standard. The discussion here establishes limits on whether and when to impose fiduciary liability on advisors.

## CONCLUSION

Discretion is widely theorized as a necessary feature of fiduciary relationships and fiduciary duties. Many, if not most, fiduciary scholars conclude that fiduciary duties arise only when one party has discretion over the assets or affairs of another. Along the same lines, scholars conclude that the reason for imposing a fiduciary duty is to constrain the fiduciary's discretion, thereby preventing misappropriation, fraud, or abuse. The discretionary authority view of the fiduciary relationship, however, is not universally valid. This Article demonstrates that, in many contexts, advisors who lack discretionary authority are and should be considered fiduciaries to their advisees. Thus, the discretionary authority view falls short as both a descriptive and normative theory of the fiduciary relationship.

An advisor's fiduciary duty is justified for reasons unconcerned with discretionary authority. A fiduciary duty for advisors stems from the nature of the relationship itself—a relationship in which the advisor invites the advisee to repose trust in the advisor, and the resulting reliance

435. *Id.* at 1379.

436. *Id.* at 1379, 1381–82.

437. *See* Velasco, *supra* note 3, at 89 (stating that an advisor should be considered a fiduciary when she is an expert in her field and likely considered a professional).

438. RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (AM. LAW INST. 1979).

and vulnerability that accompany trust. Although not every act of advice will give rise to a fiduciary duty, an examination of three criteria—holding out, primary role, and compensation—can help determine when courts can and should impose fiduciary duties on advisors.