AN INTERDISCIPLINARY VIEW OF FIDUCIARY LAW

“AS IF.” ACCOUNTABILITY AND COUNTERFACTUAL TRUST

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Tamar Frankel’s writings on fiduciary law form a continuum with her studies of ethics and trust in business.1 Her work carries even greater weight in light of the travails of Wall Street and the sense that the current financial crisis was triggered by a fatal interaction of moral failure and incompetent service. These are precisely the human frailties that fiduciary law strives to correct. Frankel interprets the classical inheritance of fiduciary law to mean that a person entrusted with the assets or affairs of another cannot treat those assets or business as their own. A fiduciary must advance and protect the interests entrusted, and hold all benefits on behalf of the entruster save for any openly negotiated payment that the terms of the entrusting agreement may provide. A fiduciary serves not as an insurer of the beneficiary interest, but as an honest guardian and prudent manager.2

My argument in this paper, offered as an affectionate tribute to a dear friend and inspiring scholar, is that the law sustains trust in fiduciaries not primarily by ordering redress of losses caused by a falling below fiduciary standards, but rather by requiring that the fiduciary be induced to act as if those standards were met. Wherever possible, the fiduciary is estopped from acting in reliance on the breach, and instead is asked to cure the breach by positive performance of duty. As a fiduciary, you do not keep the illegal profit and proffer compensation for any ensuing loss; rather, you hold the profit for the beneficiary as you always should have done, with loss measures calculated to level any shortfall. This “as if” trusting, enforced by law, solves the conundrum that complete trust properly requires no enforcement, but is self-

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2 See Frankel, Fiduciary Law, supra note 1, at 800-01.
enforcing, or better, self-fulfilling; as Frankel wisely observes, the notion of “trust but verify” is a tantalizing moral contradiction.\(^3\)

Knowing that one can be required to act “as if” one can be trusted turns out to be a powerful yet subtle constraint on destructive conduct in relationships. We see where the opposite type of behaviors can lead, when business actors no longer feel any constraint whatsoever in pursuing self-serving conduct. Recklessness and profit-gouging ultimately led to the 2008 nadir of the capital markets represented by Lehmann Brothers and AIG, with Bernie Madoff standing as the ne plus ultra of how recklessness leads into the most deceitful betrayal of trust.\(^4\) Charles Ponzi, whose defalcation of a large pool of investors after the First World War has been intensively studied by Frankel, provides a minor-league Boston precursor of these notorious Wall Street titans.\(^5\) Frankel’s work on case-studies such as Ponzi reveals that fraud is the pathological flipside, the weak underbelly, of trust – that to repose great reliance in another person gives an increased scope to the trusted person to defect from and exploit that trust. This insight helps explain the stringent profit-stripping remedies applied to the errant fiduciary – their purpose is not simply to deter and punish breach, but also to induce the particular fiduciary to act as if trust had been maintained. Breaches of trust are reversed, not priced, else the market for fraud be flooded with sellers.

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Fiduciary law provides the foundation for Frankel’s great body of work on securitization and investment management.\(^6\) Using the lens of fiduciary doctrine has helped her identify the promise and the shortfalls of modern finance. In a justly celebrated and slightly cheeky review of Frankel’s treatise on investment, the corporate scholar Robert Clark suggested that implicit in her work was the discovery of a “fourth stage of capitalism,” whereby fiduciaries take over the savings as well as the investment, control, and ownership functions of entrustors.\(^7\) Arguably Clark missed a trick or was just a little too early to see what was really happening: we are by now up to a fifth

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3 Frankel, Trust and Honesty, supra note 1, at 105-106. For a similar argument focusing on the counterfactual belief of the entrustor rather than the entrusted party, see Richard Holton, Fiduciary Relations and the Nature of Trust, 91 B.U. L. Rev. 991 (2011).


5 See, e.g., Frankel, Trust and Honesty, supra note 1, at 61-62; see also Henriques, supra note 4.


stage whereby fiduciaries are empowered by courts and legislatures to write for themselves the terms of their entrustment powers, in effect becoming co-beneficiaries of the funds they manage and potentially reaping huge profits whilst shifting the risks of mismanagement and downturn to the client beneficiaries.8

Perhaps we do not have to devise neat progressive (or regressive) stages of capitalism in order to appreciate the historical regularities by which fiduciary capitalism comes to decay into predatory capitalism. Here Frankel’s contribution has proved essential. She argues that modern financial practice represents a falling away from classical fiduciary law, and she makes a call for repentance and return. She identifies a major problem in the submergence of fiduciary law into contract.9 But fiduciary law forms its own discrete category, rooted in history and human nature, and properly separate from contract, tort, and the other departments of private law. Fiduciary law is obligational law based on voluntary undertakings, but it has many likenesses to property law, with mandatory terms forming pre-set categories of right and duty, excluding unauthorised interference with assets and reaching to bind third parties. The mandatory nature of fiduciary standards suggests that this branch of law has strong public dimensions. It is a special hallmark of fiduciary law that the fiduciary cannot vary the protections of the beneficiary without full disclosure and informed consent, and moreover that the burden of proof lies on the fiduciary to justify any departures from the rules that enforce loyalty – the prohibitions on self-interest and conflicted duties. Furthermore, the distinct equitable remedies aim to uphold duty. Injunctions, declarations, specific performance, accounting for lost or foregone assets, and analogous equitable compensation for loss put pressure on the fiduciary to eschew efficient breach and instead to serve the entrustor with loyalty – without searching for unauthorised personal gain, without weighing the cost-benefit of compliance, and without the distraction of rival interests. Such unrelenting pressure changes the incentives of the trustee or fiduciary so that the entrustor can vest the fiduciary with discretions without having to closely monitor operational decisions. Fiduciary law may be default law subject to voluntaristic renegotiation, but its special modes of formation and enforcement point to its distinctive functions in upholding trust, and it therefore cannot be collapsed into the more familiar obligational categories of contract and tort.10 Fiduciary law is not just a body of default terms allowing easier structuring of correlative legal obligations; it has significant externalities in guaranteeing the health of

8 For some figures on the scale of wealth extracted from investment management by finance professionals today, see Joshua Getzler, Fiduciary Investment in the Shadow of Financial Crisis: Was Lord Eldon Right?, 3 J. EQUITY 219, 221-23 (2009).
9 Frankel, Default Rules, supra note 1, at 1210.
the financial system, maintaining trust in professional and intimate relationships, and even guaranteeing honest service in government.

I hope Tamar Frankel will recognize the encapsulation of her views above, which she sets out afresh in her new *summa* of fiduciary law.11 There she invokes arguments drawn from law, psychology, anthropology, religion, and general history to support her vision of a fiduciary economy. I wish to elaborate Frankel’s insights in a slightly different idiom. History shows us many perspectives on complex legal and social phenomena, and not always those that we expect to find. In what follows I purpose to build on Frankel’s vision and bring reasons drawn from the doctrinal legal history of early England to further demonstrate why she is right.

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To start at the public law end of the argument, Frankel has suggested that trust and fiduciary ideas inform constitutionalism, with Locke and the *Federalist Papers* as stand-outs in use of the language of trusteeship in public office.12 Moreover, she suggests that public law morality can be used to reawaken concepts of loyal service in the private sphere. Just as government officials are entrusted with public power solely for the benefit of the people, so are fiduciaries entrusted with private power solely for the benefit of entrusters.13 That fiduciary notions underpin Western constitutionalism via Locke is just one example of how the fiduciary concept can face in many directions. Scholars have recently observed that within the boundaries of private law, the strong fiduciary duties generated by custodial trust law have been engrafted and exported into many other areas of law, notably in the law of corporations, partnerships, and agency, but also professional, familial, and public contexts.14 This is a good insight, but the “export” metaphor may be framed rather differently. Trust law – the entrusting of assets and powers by transfer from the beneficiary to the trustee – is not the core. Rather, accountability is the key concept, and historically, account duties spring from English feudal law and society where no neat split could be made between public and private, nor really between property and obligation. To hold land of another was a tight personal bond of fealty between tenant and lord as much as a horizontal relationship between possessor and purchaser or trespasser; and it is in the context of an idealized feudalism that duties of account emerged in agency, bailment, trust, and contract, mirroring the high duties to guard and protect that were woven into tenurial relationships.15 A judge generalized the

11 FRANKEL, *FIDUCIARY LAW*, supra note 1, at xiii.
12 See, e.g., JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* §§ 149, 156 at 385, 389 (Peter Laslett ed., Cambridge Univ. Press 1988) (1690); see also FRANKEL, *FIDUCIARY LAW*, supra note 1, at 279-84.
15 For overviews of the early common-law account, see J.H. BAKER, *AN INTRODUCTION*
point in 1494: “In every case where one has a thing in his keeping, he is chargeable in an action of account if he has it not to his own use.”

From the Seventeenth Century, account came to be associated with the sophisticated procedures of the equity courts, with the common law turning to use assumpsit to enforce like contractual relationships through trespassory damages.

What, then, is this accountability? To *account* to another is to *narrate* what happened to the assets or affairs entrusted to you: to give an account of what you did with your trust. On the other side of the relationship, to take an *audit* is to *hear* what is told of the assets. Account (as David Seipp rightly says in his essay) begins in the common law in a parallel legal reform to the action of novel disseisin. This was the royal writ for supervision and enforcement of the feudal relationships of protected possession between lord and tenant, adapting the Roman possessory interdicts into a feudal context. Novel disseisin and its sister writs are commonly seen as the origin of the English common law as a new system of jurisprudence, independent of the *ius commune* and distinct from French or Germanic custom. The parallel actions of nuisance and account dealt with different mischiefs: nuisance addressed interference in enjoyment of land short of dispossession, and account aimed to correct the problem of substandard stewardship of land by bailiffs entrusted with the business of farming. A bailiff who had control of a farm was expected to run the business for his lord honestly and actively, and would be *surcharged* for failing to raise crops or collect rents. This required him to make good the missing account entries from his own pocket, or else have wrongful account entries *falsified* – that is, wrongful disbursements would be cancelled and restoration of the missing assets would be required. The assets of the farm were thereby maintained at their correct level.

From “farm” – Latin *fundus* – meaning the collection of moveable and immovable assets making up an

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16 Y.B. 10 Hen. 7, fol. 6a-7a, Mich., pl. 12 (1494) (Eng.).


18 See Warren Ortman Ault, Private Jurisdiction in England 97-125, 142-44 (1923).
agricultural unit, we take the word “fund.” Fund has come to mean a bracket of value into which assets move in and out. What is distinctive about the account remedy is that it generally serves as an enforcement of the primary obligation to manage the fund effectively, involving an order to perform as if the powers of control had been exercised properly all along. Making good wrongful disbursements is not tortious compensation for loss, even though it has compensatory effect; it is rather a substitutive money performance. An accounting order restoring profits that ought to have been earned, or that were earned but kept back instead of being brought into the fund, is in form neither contractual compensation for breached performance nor an action for disgorgement of unjust enrichment, even though it has those effects. An order to produce missing profit is again a substitutive money performance – as if the collection of rents and profits had been done effectively and honestly in the first place. Thus, the accounting process does not remedy simply breach; it reverses or jumps over breach by making a specific performance order, measured as a substitutive money debt to reconstitute the trust funds or restore the fiduciary relationship to the state it ought to have been in. Sometimes the courts do use the language of correcting a breach through account for “wilful default” (a substitutive money order to reconstitute the fund following a failure to get in assets in breach of a duty to so do) or equitable “compensation” (paying over money directly to the victim of a breach of a fiduciary relationship who suffers loss). But these can be seen as variants of the core case of common accounting, or narrating the state of the trust relationship and assets, and ensuring a due performance of the primary duties. Account to maintain the performance of duties, rather than trespassory damages for harm to rights, is the pre-eminent common law remedy in this context. It presumes the honesty and competence of the agent and asks the agent to act as if all duties had been duly performed. The remedy expresses the right – it is not a reaction to the right being breached. It is a nineteenth-century notion,

19 For further discussion, see Joshua Getzler, Plural Ownership, Funds, and the Aggregation of Wills, 10 THEORETICAL INQUIRIES IN LAW 241, 243 (2009).

20 See infra note 21.

21 Chambers, supra note 15, at 7-12, argues for separation of the categories of common account and account for wilful default, both of which restore the trust, and equitable compensation, which provides a secondary remedy, arguing also that each turns on a breach of trust or duty. Damages rather than account are ordered to be paid where, for example, the trust has ended or the fiduciary relationship does not entail any custodial account capable of restoration. Others have argued that no breach is required for common account. See Mitchell & Watterson, supra note 15, at 120-27. I have argued that the impulse for each of these remedies is basically the same whether put in primary, secondary, strict, or fault liability terms. Joshua Getzler, Am I My Beneficiary’s Keeper? Fusion and Loss-Based Fiduciary Remedies, in EQUITY IN COMMERCIAL LAW 239, 251 (Simone Degeling & James Edelman eds., 2005); Joshua Getzler, Equitable Compensation and the Regulation of Fiduciary Relationships, in 1 RESTITUTION AND EQUITY: RESULTING TRUSTS AND EQUITABLE COMPENSATION 235, 236-37 (Peter Birks & Francis Rose eds., 2000).
popularised by John Austin, that a breached primary obligation always gives rise in a discrete stage of legal analysis to a secondary remedial obligation, whether crafted \textit{ex ante} by the parties (pre-estimated damages, deposits, and so on), or imposed by the courts. In earlier law the substantive right, the remedy, and the writ of action to assert the right and seek the remedy, were not so easily divided, and this is not, \textit{pace} Henry Maine, because substantive rights were an epiphenomenon of the forms of action in an unevolved system.\textsuperscript{22} It is simply a different method of legal thinking. We can see account ideas expressed in contract cases down to the mid-Nineteenth Century. Thus, the great common-law judge Baron Parke stated in 1848: “The rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, \textit{as if the contract had been performed}.”\textsuperscript{23} But the notion of damages for loss caused by breach soon after displaced this concept of substitutive performance.

The concept of accounting, or keeping up due performances in a continuous relationship of stewardship over property or powers, is found in other parts of the old common law. On the contract side, the writ of account was a popular alternative to writs of covenant and debt down to 1600, used particularly for enforcing continuous contractual relationships.\textsuperscript{24} On the estate law side, the Magna Carta of 1215 and the Statute of Marlborough of 1267 codified the practice whereby lords who took guardianship of a minor heir’s socage lands (the standard non-military tenure) would have to account for all estate profits made where the minor had reached the age of fourteen, and avoid wasting or appropriating the value of the land.\textsuperscript{25} In another stream of law, the church courts enforced accounting of executors charged with the management and disposition of the chattels of deceased estates; as Richard Helmholz has shown, this was a potent source of fiduciary accounting ideas for early chancery enforcement of uses.\textsuperscript{26} I would argue that by the time the Court of Chancery

\textsuperscript{22} \textit{Cf.} \textsc{Sir Henry Sumner Maine, On Early Law and Custom} 389 (London, John Murray 1890).

\textsuperscript{23} Robinson v. Harman, (1848) 154 Eng. Rep. 363, 365 (emphasis added). For an argument that modern law should reproduce the substitutive performance idea for contracts, and has been doing so in the past decade and a half in many cases, see James Edelman, \textit{Money Awards of the Cost of Performance}, \textsc{4 J. Equity} 122 (2010), \textit{available at} http://ssrn.com/abstract=1697669.

\textsuperscript{24} \textsc{Baker, An Introduction To English Legal History, supra} note 15, at 362-78.

\textsuperscript{25} \textsc{Brand, supra} note 15, at 348-61; Antonio Buí, \textit{The Early History of the Law of Guardianship of Children: From Rome to the Tenures Abolition Act 1660}, \textsc{7 U. W. Sydney L. Rev.} 91, 97-100 (2003).

\textsuperscript{26} \textsc{1 R.H. Helmholz, The Oxford History of the Laws of England: The Canon Law and Ecclesiastical Jurisdiction from 597 to the 1640s,} at 421-23 (2004); \textsc{R. H. Helmholz, The Early Enforcement of Uses,} \textsc{79 Colum. L. Rev.} 1503, 1504 (1979); \textsc{Richard Helmholz, Trusts in the English Ecclesiastical Courts 1300-1640, in Itinera Fiduciae: Trust and Treuhand in Historical Perspective} 153, 157-60 (Richard Helmholz &
was regularly enforcing uses of land from the Fifteenth Century, it could draw on a body of fiduciary accounting ideas to add to its own distinct theory of holding of land subject to duties of equitable conscience. The “holding to the use of” idea then spread into other parts of property and contract, with equitable in personam orders of specific performance and rescission helping to enforce trust and contract claims and binding successor third parties to respect beneficial interests.

Why is the medieval history important? My answer is that it shows how the accounting duties of fiduciaries come first, as emanations of royal enforcement of the feudal economy of entrustment of powers. This idea is then applied to estates, giving rise to the trust, and then to continuous contractual relationships such as agencies, which further build up the power and definition of fiduciary doctrine. Chancery takes over the enforcement of such duties, but does not invent them; fiduciary law is not intrinsically “equitable.”27 Putting it another way, the trust is a particular instantiation of fiduciary law; fiduciary law is not an offshoot of trusts law. All of this fiduciary law works according to the idea that equity typically enforces a primary performance interest, as if the fiduciary were honest and capable, through the positive accounting remedies, notably disgorgement and surcharge remedies, and specific performance. This body of law also strikes down actions that are beyond power, by avoidance, rescission, and the falsification of account remedy. The compensatory, deterrent, and prophylactic effects of equitable orders are side products of the primary performance mechanism. A fiduciary must compensate for losses flowing from breach on a but-for causal basis, without reductions for contributory fault or remoteness, and a fiduciary cannot profit from any conduct in breach of loyalty and single-minded promotion of the beneficiary’s interests. These remedies are applied not as sanctions but rather because one is prevented from carrying out one’s breach. This explains the persistence of but-for causal measures of liability; for example, you cannot speculate about contributory causes of loss if you are simply required to perform your duty to correct the loss, and you cannot claim as of right a proportionate share of profits created by your own efforts where breach of fiduciary duty was a material source of the profit.28 And, at least classically, if not in North American law, one cannot be attached with penal damages to remedy an egregious breach of fiduciary

Reinhard Zimmermann eds., 1998).

27 See, e.g., 2 Henry Ballow, A Treatise of Equity 178-90 (John Fonblanque ed., 1794).

28 Regal (Hastings) Ltd. v. Gulliver, [1967] 2 A.C. 134 (H.L.) (appeal taken from Eng.); Phipps v. Boardman, [1967] 2 A.C. 46 (H.L.) (appeal taken from Eng.). But cf. Murad v. Al-Saraj, [2005] EWCA (Civ) 959, [85] (Eng.); Warman Int’l Ltd. v. Dwyer (1995) 182 CLR 544, 561 (Austl.) (“In the case of a business it may well be inappropriate and inequitable to compel the errant fiduciary to account for the whole of the profit of his conduct of the business or his exploitation of the principal’s goodwill over an indefinite period of time. In such a case, it may be appropriate to allow the fiduciary a proportion of the profits, depending upon the particular circumstances.”).
duty (though such damages may apply concurrently to address dishonest, as opposed to presumptive, fraud).

We began with the Lockean idea of public trust, of duties of selfless and loyal service informing the vertical contract between government officials and the people. Frankel reminds us in her treatise just how radical in its time was the Lockean model of the fiduciary government official who served the public. Public offices were once owned and even inherited as capital investments bought in anticipation of fee income, and bequeathed as valuable income streams to heirs. Frankel argues that fiduciary law in the early modern period transformed the concept of an office by cutting away the self-interest, leaving a powerful obligation of service to the public. Two ideas complete this story. First, the concept of holding an office stripped of self-interest could plausibly be the very definition of what it means to be a fiduciary. It is quite easy for civilian lawyers (more accurately, lawyers working in cross-bred civil/common law jurisdictions such as Quebec, Scotland, and South Africa) to see fiduciary duties as an office enwrapping the officeholder with duties, a superimposed personal role recognized by law. We take these ideas from the classical concept of officium, the sense of duty belonging to a person with recognized responsibilities. So for a fiduciary, holding such an office accents and shapes all the relevant duties, positive and negative, that are owed by the fiduciary to a beneficiary. The conception of a fiduciary office arises especially in the context of executorship, and it is increasingly used by modern civilian analysts to find a place between property and contract that does not require the evocation of artificial legal personality to explain the asset-partitioning magic of the trust. So fiduciary office becomes a useful

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29 See Vyse v. Foster, (1872) 8 Ch.App. 309, 333 (James L.J.) (Eng.); see also Harris v Digital Pulse Pty. Ltd. [2003] 56 NSWLR 298, 407 (Heydon, JA) (Austl.).

30 FRANKEL, FIDUCIARY LAW, supra note 1, at 279-84.

31 Id.

32 The locus classicus is of course MARCUS TULLIUS CICERO, DE OFFICIIS 6 (Arthur L. Humphreys 1902) (44 B.C.E.), which for centuries provided a foundation in Europe for the education of persons preparing for a legal career, not least John Scott and later Lord Eldon, who wrote a lengthy paraphrase of De Officiis as a young student in the 1760s. See A Catalogue of Lord Chancellor Eldon’s Law Books, GEORGETOWN LAW LIBRARY, http://www.ll.georgetown.edu/special/eldon/eldontitles.cfm.


34 See generally George L. Gretton, Trusts Without Equity, 49 INT’L & COMP. L.Q. 599
concept not only for export of loyalty duties into government roles, but also for explaining fiduciary duties in their core territory of private law.

The second idea about the role of office-holding is that fiduciary law historically attained a deeper self-consciousness when legal officials in the early modern state perceived irreconcilable tensions between self-interest and specifically judicial propriety. In an interesting dialectic, the judiciary intensified fiduciary law for private actors when the judicial apparatus of the state saw the need to cleanse itself of self-interest. The guardians of the legal system had to learn to guard against themselves, and thereby set an example to the rest of the populace. The discovery of fiduciary morality did not come easily, and there were some spectacular fallings-down. It is well-known that Lord Chancellors who presided over the trusts and estates system, as practicing politicians wielding a relatively free discretion over Chancery decrees, were regularly impeached for corruption or misfeasance. In part this was common-law resentment of Chancery interference in the legal process, but there could be fire beneath the smoke. Francis Bacon was forced out of the Chancellorship in 1621, partly for accepting bribes that exceeded even the Elizabethan and Stuart courts’ lax norms. His defense was that, while he took gifts from parties in disputes over estates, he did not let the gifts cloud or influence his judgments.35 I do not think he was trying to be ironic; rather, he saw the gifts as an acceptable emolument of office. Bacon died of a chill five years later, after stuffing a chicken with snow in a pragmatic experiment in food preservation by refrigeration, and perhaps we can thank his prosecutors for releasing his energies for science and philosophy in his later years.36

A century after Lord Chancellor Bacon’s fall, another chancellor, Lord Macclesfield, was impeached for corruption, and fiduciary law again was at the heart of the conviction. The story is little known and well worth recounting.37 By the early 1700s, the Court of Chancery was acting as an investment conduit, a kind of semi-official fidelity fund and pension broker, channelling trust estates and fortunes into the informally approved funds of the new Bank of England and the other “monied” companies such as the East India Company. Unfortunately, in the years running up to 1720, the South Sea Company was a special investors’ favorite, and Macclesfield allowed himself and the Masters of Chancery to lift suitors’ funds from the court and invest them in the South Sea Bubble on their own personal account. Macclesfield’s defense was that he could justly keep the profits since he would personally be

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36 Id.

liable for any losses on the writ of account; in effect the argument was that he who has the risk pockets the gains, an argument that had been run for executors in past case law. All the capital taken from Chancery funds was lost when the Bubble burst in 1720, and Macclesfield’s risk-based argument for investor protection proved useless in the face of the systemic insolvency that resulted; the errant fiduciaries were in no position to personally account for the losses.

Enter Peter King, a Whig parliamentarian and lawyer who had risen through the Court of Common Pleas and was thus removed from the lax culture of the Chancery. As a member of Parliament, King had long criticized tory and Crown officials for their corruption and incompetence in service to the public. He particularly opposed the sale and pecuniary exploitation of public offices. The tory court of Queen Anne opposed his promotion as a Crown law officer, but George I appointed him Chief Justice of the Court of Common Pleas in 1714. He tried the Jacobite rebels with mercy and humanity, and took his place in the line of gifted lawyers from Holt to Mansfield with his creative decisions in commercial law. It was Chief Justice King who presided over Macclesfield’s impeachment in the Lords, and he was appointed to succeed the disgraced judge as Lord Chancellor in 1725, with a brief to restore the reputation and effectiveness of the Court of Chancery. Lord Chancellor King refused to follow the practice of selling the Chancery masterships as capital investments, but added £12,000 to his £6,000 public pension in substitution for that questionable income stream. He required that litigants’ monies be paid into a separate fund of the Bank of England, appointed an accountant to control all payments and securities brought into court, and took measures to indemnify any suitor whose money was lost by an official’s bankruptcy or insolvency. King may have instigated moves by Parliament in the 1730s to have all legal proceedings conducted in English and to control the exorbitant expenses and delays of litigation in equity and the common law.

It is Lord Chancellor King who crystallized the idea that a fiduciary assumes an office that permits no profit or conflict of interest. From the time of his appointment to the chancellorship in 1725, and indeed for nearly a century to follow, the business classes of England were still reeling from the disintegration of confidence in the capital markets following the South Sea Bubble of 1720. The peculations of the Chancery masters were only one


39 See Getzler, supra note 37, at 581-85.

40 The impact of the Bubble on the law is examined in Ron Harris, Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844, at 60-81 (2000). Certainly the events of 1720 reached into the minds of trusts lawyers. Lord Chancellor Hardwicke wryly commented, “But it is well known, that during the golden dream, people were so infatuated as to look upon imaginary wealth as equally valuable with
small element in those losses, but just in this instance the losses in the 1720 crash produced a defalcation of some £100,871 of suitors’ payments into court, a staggering sum for that period – £160 million (equivalent to approximately $260 million USD) in today’s money calculated on an average income index. This was failure enough to cause an abrupt change of course in the practices of the Chancery Court. King’s attacks on the sinecurism, speculation, and corruption of the officials of Chancery came with a new prophylactic policy announced at the start of his chancellorship, which involved a run of stringently moralistic decisions disciplining trustees, guardians, co-owners, mortgagees, and so on. The culmination was the celebrated decision of Keech v. Sandford, which held that where a trustee takes a profit from office, it is to be surrendered on account or constructive trust, without proof of fraud, and without any defense that the profit was not at the expense of any opportunity to the beneficiary or had caused the beneficiary no loss. This “no further inquiry” principle has been attacked as too stringent a clamp on the activity of trustees and fiduciaries, which could inhibit their serving the best interests of entrustors. What is less well-known about Keech is that the pleadings alleged that the trustee had stolen trust funds and bribed the counterparty to deny estate benefits to the beneficiary and offer them instead to the fiduciary. Lord King stated: “I do not say there is a fraud in this case” because the facts of fiduciary profit-taking so easily raised a presumption of propriety; he did not have to spell out the fraud in the case before him because everyone in court knew what was being alleged. Although the case deserves its celebrity, it is to this day not fully understood.

We can find plentiful evidence that scandals in the public sphere often led to tightening of fiduciary regulation across the board. Another important conduit
was the charitable trust and the chartered corporation, where funds and entities were constituted for public ends such as infrastructural development, municipal and colonial government, and welfare functions. Major defalcations occurred in cases such as *Charitable Corp. v. Sutton*, a savings-and-loan style scam of 1742 where over £300,000 was embezzled (nearly half a billion pounds, or $800 million USD, in today’s money terms), or *York Buildings Co. v. Mackenzie*, a 1795 case involving delinquency in the running of a court-ordered auction of a large insolvent estate which led to a vast undervaluing of the assets. These scandalous cases were important staging posts in the crystallization of modern fiduciary doctrine.

One further case of the following century may be instructive. One Justice Albert Cardozo, a judge of the Supreme Court of New York, was disgraced and driven from office in 1868 when it emerged that he had been suborned by business interests during the battles over the Erie Railway. It may be no accident that he had a lawyer son who much later penned one of the most powerful and demanding formulations of fiduciary doctrine in common-law history.

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It has been said that fiduciary law has been caught between the strategies of disempowering the fiduciary by setting limits to capacity, and of applying *ex post* requirements that the fiduciary should use his or her wide powers to seek the beneficiary’s best interests, or at least refrain from conflicted behavior that undercuts best interests. Robert Sitkoff has elegantly restated this thesis using a law-and-economics idiom. But perhaps this model too needs some historical tweaking. English law classically spoke of disabilities and limits to power, and by the time of Lord Mansfield had already invented a plethora of tests for the proper exercise of powers that preserved the validity of such actions at law, but that rendered transactions subject to avoidance in equity at the suit of the beneficiary. Third parties could find their acquired rights under impeached transactions vulnerable, but could establish priority and render the beneficiary right defeasible by suitable defenses, notably innocent acquisition for value. The remedy that is especially associated with enforcement of

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50 See Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).
51 For a detailed defense of this approach, see MATTHEW CONAGLEN, FIDUCIARY LOYALTY: PROTECTING THE DUE PERFORMANCE OF NON-FIDUCIARY DUTIES 1-6 (2010).
fiduciary obligation, profit-stripping, can be seen alternatively as rescission of wrongful transactions, treating the transactions as if they had not occurred (with injunction as a future-oriented variant) or else as ratification, or post-facto authorization, of wrongful actions and adoption as if they were acts done for the trust. The beneficiary thus polices the fiduciary through constant measurement of the manner in which power is exercised – not just the limits or outer scope of that power, as in classical corporate ultra vires. We can see how the control of powers of charitable and municipal corporations in Lord Mansfield’s time leaked from Chancery to the King’s Bench and so laid the foundations for judicial review of public powers.53 This indicates another historical cross-over that buttresses Frankel’s argument about the importance of public office in forcing fiduciary notions into their modern form.

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One of the hottest topics in modern fiduciary law is how consent may be inferred from formal or informal agreement or from business context so as to displace or read down the scope and intensity or even the very existence of fiduciary loyalty duties. If we see such duties as based on office or status relationships, bringing stringent regulation of associated powers through the accounting technique of primary enforcement, then the fiduciary standard of full subjective understanding of the terms of engagement will apply to any downgrading of fiduciary expectations. Lord Eldon, in the classic 1802 case of Ex parte Lacey, explained how fiduciary law worked when dealing with a trustee who bid to buy for himself the trust property he was selling at an open auction, and his judgment explains with great clarity and power both the primary enforcement technique and the centrality of informed consent:

The rule I take to be this; not, that a trustee cannot buy from his Cestuy que trust, but, that he shall not buy from himself. . . . A trustee, who is entrusted to sell and manage for others, undertakes in the same moment, in which he becomes a trustee, not to manage for the benefit and advantage of himself. It does not preclude a new contract with those, who have entrusted him. It does not preclude him from bargaining, that he will no longer act as a trustee. The Cestuys que trust may by a new contract dismiss him from that character: but even then that transaction, by which they dismiss him, must according to the rules of this Court be watched with infinite and the most guarded jealousy; and for this reason;

that the Law supposes him to have acquired all the knowledge a trustee may acquire; which may be very useful to him; but the communication of which to the Cestuy que trust the Court can never be sure he has made, when entering into the new contract, by which he is discharged. I disavow . . . that the trustee must make advantage. I say, whether he makes advantage, or not, if the connection does not satisfactorily appear to have been dissolved, it is in the choice of the Cestuy que trusts, whether they will take back the property, or not; if the trustee has made no advantage. It is founded upon this; that though you may see in a particular case, that he has not made advantage, it is utterly impossible to examine upon satisfactory evidence in the power of the Court, by which I mean, in the power of the parties, in ninety-nine cases out of an hundred, whether he has made advantage, or not. Suppose, a trustee buys any estate; and by the knowledge acquired in that character discovers a valuable coal-mine under it; and locking that up in his own breast enters into a contract with the Cestuy que trust: if he chooses to deny it, how can the Court try that against that denial? The probability is, that a trustee, who has once conceived such a purpose, will never disclose it; and the Cestuy que trust will be effectually defrauded.54

More recently, the problem of fiduciaries preying upon entrustors was rehearsed in relation to the Crown as a governmental fiduciary in the 1977 case of Tito v. Waddell (No. 2).55 The United Kingdom Crown government had made undertakings in the early Twentieth Century to the natives of an island to restore the island to habitability after strip-mining it for phosphates and to share the mining royalties.56 The Crown was the direct sovereign with strong prerogative powers over the government of the island territory. Over a long stretch of time, the Crown negotiated for further land acquisition and a shaving back of the royalties due, which were now paid into a collective fund controlled by the Crown. When the time came to perform the promised duty of restoring the island, the Crown preferred to pay damages for efficient breach, which was much cheaper than the promised restoration. The natives sued the Crown as fiduciary, inter alia, for breach of the fair dealing and self-dealing rules. Vice-Chancellor Megarry refused relief on the basis that the Crown was immunized by a sovereign immunity from fiduciary duty, a decision controversial to this day. For our purposes, the case is fascinating for its revival of the older techniques of avoidance and rescission to enforce fiduciary duty.

Vice-Chancellor Megarry listed the remedies under two heads:

55 [1977] Ch. 106 (Eng.).
56 Id. at 125-46.
(1) The self-dealing rule: if a trustee purchases trust property from himself, any beneficiary may have the sale set aside ex debito justitiae, however fair the transaction.

(2) The fair-dealing rule: if a trustee purchases his beneficiary’s beneficial interest, the beneficiary may have the sale set aside unless the trustee can establish the propriety of the transaction, showing that he had taken no advantage of his position and that the beneficiary was fully informed and received full value...

[T]hese rules, or either of them, apply not only to trusts but also to other cases where there is a fiduciary relationship, springing perhaps from agency, or partnership or membership of a committee of inspection in bankruptcy...

The stronger first case rests on the ultra vires conduct of a trustee taking a legal title to himself purged of the inconsistent beneficial interest. The weaker second case involves equitable rescission of a positive dealing in the beneficial interest, which is inimical to the fiduciary relationship. Again, it is ultra vires to so meddle with the beneficial interest, and the trustee is made to act as if the wrongful sale is never made. Whatever the equities of the actual case, it demonstrates that the old rescissionary remedies are not archaic rules but rather provide the core of modern equitable remedies for abuse of fiduciary office.

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Tamar Frankel has described how different federal and state courts have grappled with these very same problems of finding a language to explain the identification, the content, and the remedying of fiduciary duties in modern American law. She is right to argue that the characterization of fiduciary standards and procedures is not just a policy choice, but an architectural choice about how our law fits together. In this paper, I have tried to suggest the importance of knowing how the common law and Chancery courts historically evolved the structure of fiduciary rights and remedies, and I suggested how the historical material continues to shape what courts do. These long centuries of evolved doctrine amount to “unknown knowns,” a body of law dimly recollected but largely forgotten. It is well worth recovering. But we can also put the case using the language of modern law and economics.

Fiduciary law might be the sole living example of the “penalty default rule” construct identified by Ian Ayres and Robert Gertner in a controversial paper two decades ago. They postulated a rule that perhaps the majority of market

57 Id. at 225.
58 Cf. CONAGLEN, supra note 51, at 125-39 (relying on cases extending back to the 1700s to explain the development of the fair-dealing rule); Matthew Conaglen, A Re-Appraisal of the Fiduciary Self-Dealing and Fair-Dealing Rules, 65 CAMBRIDGE L.J. 366, 368 (2006) (arguing that both the self-dealing rule and the fair-dealing rule represent applications of the fiduciary conflict principle).
59 Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic
actors would not have chosen because it sets duties too high or too low. The default rule is therefore perceived to be a “penalty,” an unacceptable equilibrium to be contracted away from. The search for a new equilibrium encourages release of information and revelation of preferences by self-aware and rational actors, who will renegotiate terms and tailor the level of protection to their special needs. In fiduciary law, the default rule can set high protections against conflict of interests and duties, perhaps too high for most sophisticated actors to be comfortable; the parties are thus free to adapt these rules where this brings them countervailing advantages. The law can then leave in place a highly protective default position for less sophisticated actors who cannot easily bargain or do not know which equilibrium to bargain for. Moral hazard and temptation to abuse fiduciary power by redrawing relationships in favor of the fiduciary is reduced when the law applies stringent disclosure rules to ensure that any departures from the default rule are well-understood and consent is well-informed. The costs of forcing many or most parties to bargain around the over-stringent fiduciary default position is therefore justified because the payoff to individuals and society of honest and faithful service is very high. The parties face a tradeoff between moral hazard in trusting the other side and freedom to act in transacting with the other side and third parties. Fiduciary disclosure and consent rules ensure that the balance of risk and protection is set to the level the parties actually accept, with full information and eyes wide open; absent such consent, the default position should be very demanding of the fiduciary. In other words, a fiduciary standard is applied to attempts to vary the fiduciary standard, a kind of double entrenchment that still permits ready enough variation if the parties truly wish it. There may be a good case for setting efficient rather than penalty default rules in normal contracting, where the majority of parties do not win much value from having to release information and dicker over the precise setting of contractual standards. Objective consent there suffices to shift the goalposts. But in long-term discretionary fiduciary relationships, where value is easily destroyed or appropriated by opportunistic agents, it is important that the law help the parties set workable incentives. This means that parties should be encouraged in the first instance to bond to give up self-interest and divided loyalties as a condition of service, with consensual variation of reduced protection being permitted but relatively much harder to attain than in shorter term contracts. The courts should not allow informed consent to turn into a merely formal process, and as we have seen, there are plenty of historical precedents as well as abstract arguments to help them hold


the line. Understanding that history, as Tamar Frankel demonstrates in her great span of work on fiduciary duties, is an essential prelude to getting the law right.