(4) The issuers' costs of monitoring fiduciaries' use of entrusted power are likely to exceed entrusters' benefits from the relationship. For example, if the issuer's interests conflict with those of the entrustee, the value of its advice, even its expert advice, is doubtful. Monitoring such conflicts of interest is costly. Similarly, the very utility of the relationship for clients would be undermined if the clients must watch over their discretionary investment managers to prevent abuse of power.

(5) But many issuers monitoring the quality of fiduciary services are likely to be too high, because most fiduciary service
t Token retails expensive that entrusters do not pay. These monitoring costs may exceed the benefits to entrusters from the relationship. For example, if clients can check the quality of their investment advisors' recommendations, the advice is worth little. Similarly, clients cannot evaluate legal advice except by hiring other lawyers or undertaking a costly study of law. In addition, the quality of some services cannot be determined by its results: a defendant may lose his case even if his lawyer has performed tril

(6) The fiduciaries' costs of reducing the entrusters' monitoring costs may exceed the benefits to fiduciaries from the relationship. Fiduciaries can reduce entrusters' monitoring costs by "hiding", insurance and third-party guarantees, provided their costs do not exceed their benefits from the relationship. Because of these limits, their efforts may not be enough to fully cover the entrusters' risks of loss.

(7) Alternative external controls that reduce entrusters' risks, such as market controls, either do not exist or are too weak. Courts recognize new fiduciary duties when, in their opinion, the historical protections of entrustees have eroded. For example, physicists recently joined the family of fiduciaries as they became involved in conflict of interest situations - when physicians own pharmaceuticals that supply their patients' medicines, or when the interests of the patients' employers conflict with the patients' optimal medical treatment. (See Rooker 1991). Similarly, recog

The Supreme Court of Canada declared accountants giving investment advice to be fiduciaries. The Court found that an accountant breached his fiduciary duty when he recommended to a client tax-sheltered investments without disclosing his personal interest in those investments (see Hodgins v. Simon). The reserve is also true. When unsound entities over fiduciary tightens, clients are likely to relax their supervi
sion over these fiduciaries. For example, in the United States, courts impose limited fiduciary duties on securities brokers, depending on the circumstances of the relationship. Courts may believe that the controls exerted by the markets, the Securities and Exchange Commission, and the National Association of Securities Dealers provide alternative external controls to investors, and perhaps judges have concluded that the judicial system has been overemphasized as claims against brokers have increased dramatically. In short, the weakening of entrusters' protection may trigger recognition of new fiduciary relationships and stricter duties on existing fiduciaries, while the strengthening of alternative protection may reduce or even eliminate fidu

ciary duties (see Franklin 1983 and 1993).

(11) The purpose of this article is to examine the relationship between fiduciary law and the duty to a third party in the context of fiduciary law.

We revisit this issue in the last section of this essay. THE PURPOSE AND EFFECT OF FIDUCIARY DUTIES. Fiduciary duties are imposed when public policy encourages specialization in particular services, such as money management or lawyering, and when the entrustees' costs of specifying and monitoring the fiduciaries' functions threaten to undermine the utility of the relationship to entrusters. The ultimate effect of the law is to provide entrusters with incentives to enter into fiduciary relationships, by reducing entrusters' risks and costs of preventing abuse of entrusted power, and of ensuring quality fiduciary services. Judicial enforcement of fiduciary duties further entrusters' costs to taxpayers.

The law impacts on fiduciary duties that limit the firm's freedom but includes it in the medium by ensuring them with a reputation for honesty backed by regulation.

JUDICIAL DENIAL OF FIDUCIARY STATUS. Courts are likely to deny fiduciary status to entities that do not involve property, perhaps because the historical purpose of regulating fiduciaries was to protect property owners. Further, courts may refuse to extend fiduciary law when its application would present doctrinal problems (see Singer 1986; Franklin 1993) in order to protect parties can hardly be justified by specific contract terms. For example, US courts refused to extend fiduciary duties on corporation directors towards corporate bondholders or employees; these are deemed to be the property of the corporation, not entrusters (see McDaniel 1986). Simil

larly, courts did not impose fiduciary duties on banks with their depositors (see Home v. Chase National Bank) and on insurance companies towards their policyholders (see Rockefeller Safety Assocs. PC v. Ames Life Ins. Co.) and held both institutions to be debtors. As trustees, banks and insur
ance companies would have had to set aside deposits or reserves, undermining the very utility of banking and insur
ance, which requires pooling. In contrast, legislation generally applies fiduciary duties procedurally, as the regulation of banking and insurance demonstrates. Legislation imposes fiduciary duties on the use of superior knowledge, skill, or care on these institutional debits, which, dec

The relationship between fiduciary duties and current stock exchange law is the subject of this essay. It will be argued that current stock exchange law does not adequately protect the public interest and that it is time to re-examine the relationship between fiduciary law and the duty to a third party. The purpose of this article is to examine the relationship between fiduciary law and the duty to a third party in the context of fiduciary law.
Fiduciary duties

Judicial creation of fiduciary duties. Courts apply fiduciary law in three steps. They (1) define the functions that particular fiduciaries are expected to serve; (2) determine the powers vested in the fiduciaries to perform these functions, which vary, depending on the parties' agreements and actions, and circumstances of the relationship; and in light of these functions and powers (3) design the regulatory regime for the particular cases before them. As the Supreme Court of the United States declared more than fifty years ago: "It is clear that a man in a fiduciary only begins analysis, it gives direction to further inquiry. To whom is he a fiduciary: What obligations does he owe as a fiduciary? In what respects he has failed to discharge these obligations? And what are the consequences of his deviation from duty? (see, e.g., Chinery Corp., 85–86). Courts also determine the degree of skill that fiduciaries must possess in performing their functions. Unless the fiduciaries profess to possess certain skills, or the parties specify them, the courts derive the degree of required skill from the type of expected services, the circumstances surrounding the relationship (e.g., the responsibility involved in providing the services) and the fees paid for them. Having determined the functions and powers of a fiduciary in a particular relationship, courts regulate the fiduciary in the exercise of these powers mainly to reduce entrusters' risk from misappropriation of entrusted power, and secondarily, from inappropriate performance.

Doctrine of fiduciary duties. Fiduciary law vests in entrusters the legal right to rely on the honesty of their fiduciaries by imposing on fiduciaries a corresponding duty of loyalty and other specific duties to deter dishonesty. In enforcing these duties, which constitute the bulk of fiduciary law, courts follow principles similar to those underlying the crime of embezzlement (see LaFave and Scott [1972] 1986) and the tort of conversion (see Prosser and Keeton [1941] 1955, Wharton: Regents of the University of California). The duty of loyalty addresses the risk of officers or entrusted power to which entrusters are exposed. Further, fiduciary law vests in entrusters the legal right to receive quality fiduciary services, commensurate with reasonable expectations and corresponding skill in performance of the services. Breach of this duty is similar to the tort of negligence, and addresses the entrusters' risk of low-quality fiduciary services.

Duty of loyalty. Some court decisions may suggest that the duty of loyalty requires fiduciaries to be altruistic: to comply fully to the interests of entrusters, and put their interests before their own. The substance of these decisions suggests a narrower interpretation. Fiduciaries need not sacrifice their property and interests to benefit entrusters. The duty of loyalty is limited to the entrusted power that fiduciaries receive for the purpose of performing their services. The duty requires fiduciaries to be honest: refrain from converting entrusted power to unauthorized uses. The enforcement of the duty of loyalty is implemented by preventive duties that dampen temptation, especially when fiduciaries deal with entrusted property over long periods. Here are a number of examples:

(1) Fiduciaries should segregate and earmark entrusted assets. This duty protects entrusters from claims of creditors of fiduciaries in financial difficulties. Segregation constitutes notice to potential creditors that assets, which fiduciaries seem to own, belong to others. Earmarking prevents fiduciaries from allocating losing investments to entrusters and successful investments to themselves, after the fact. Because people are creatures of habit, segregation and earmarking also reduce the likelihood that fiduciaries would view other people's assets as their own. Segregation and earmarking remand fiduciaries every time they look at, or think about, entrusted property, so that they do not own it even if they control it.

(2) Fiduciaries may not create situations in which their own interests conflict with those of the entrusters, for example, buying entrusted property while acting on behalf of entrusters. The prohibition is based on a rebuttable presumption, borne out by experience, that conflict of interest transactions would benefit fiduciaries at the expense of entrusters, and is designed to avoid temptations to use entrusted powers for the fiduciaries' own benefit. However, because such transactions could benefit both parties, the law does not disallow them altogether. Such transactions are permitted with the consent of the entrusters, or third parties on their behalf, or under corporate law—third parties and the courts, or under the Investment Company Act of 1940—the Securities and Exchange Commission. Such consents are aimed to assure that the terms of the transactions will mirror those reached at arm's length negotiations. The prohibition on conflict of interest transactions does not preclude fiduciaries from having interests that conflict with those of their entrusters, for example in seeking compensation. Sometimes the line between permissible and impermissible conflicts of interest is blurred. For example, while employees may use for their own benefit knowledge, information and some of the personal contacts they acquired during their employments, they may not, in commencing a business of their own, use the employment's proprietary information, nor enter into contracts away from their employer before leaving. Similarly, controlling shareholders could sell their company for a price below the fair price because of cost savings and other advantages that control blocking blocks of shares present. The better view, however, is that they hold their power over the minority shareholders' interests as fiduciaries, and may not sell the control over the minority's shares, especially if the shares have no liquid market.

Similarly, although a trustee may not usually have a conflict of interest with his beneficiaries, a court may refuse to remove such a trustee if he is a son, appointed by his deceased father as trustee for the benefit of himself and his mother, in order to continue operating the family business. In this case the father is presumed to have known the son's integrity far better than the court, his familial relationship would protect the mother, even if the court perceives otherwise and, presumably, the son will operate the family business better than any outsider.

(3) Fiduciaries may not compete with their entrusters. Competition would tempt fiduciaries to use their entrusted powers for their own benefit. Because competition is unlikely...
to benefit entrustees, entrustees' consent will be closely examined to ensure that it is informed and independent.

(b) Fiduciaries must premise their action with information and accounting. Information and accounting as to the use of entrusted powers helps reduce both mistrust and the entrustees' costs of monitoring.

The duty of care. Like the duty of loyalty, the duty of care is triggered when the entrustees' high costs of monitoring a fiduciary's performance exceed the entrustees' potential losses from entrusting the relationship. As compared to the duty of loyalty, the duty of care is generally considered the lesser fiduciary duty. Arguably, it is imposed when there is a suspicion of conflict of interest but no proof. The duty of care requires fiduciaries to perform their services with care and skill that can be reasonably expected of them in the particular situation. If fiduciaries possess or purport to possess certain skills, they must use them to benefit entrustees. Reflecting the tort of negligence, "care" denotes caution, and is especially relevant for trustees required to preserve trust capital. The duties in broader, however, and relates to the fiduciaries' decision-making process. It requires them to (1) gather pertinent information; (2) focus — pay attention — and deliberate before making a decision; and (3) use their skills in the process.

The standard of care that fiduciaries want exercise is often measured by the care that they would reasonably exercise in their own affairs. In corporate law the standard follows the protection: care exercised by holders of similar positions. The distinctions between private fiduciaries that service a small number of entrustees (whether individually or entities) and those that service many entrustees is not well developed. Yet, this distinction plays a role in shaping fiduciary duties because the sophistication of those duties generally depends on entrustees, monitoring, and controls that entrustees can exercise in each situation.

The design of fiduciary duties. The objectives of fiduciary law and the circumstances which give rise to the need for fiduciary duties are inextricably linked. Fiduciary duties are no uniform. Fiduciary duties vary with the costs of specifying and monitoring entrustees' services, the degree of monitoring, and the risk of losses from the relationship to entrustees, and the extent to which there are no alternative mechanisms to protect entrustees from such risks.

Thus, because entrustors and beneficiaries can perform their services with little discretion over property entrusted to them, and their duties can be easily specified, their duties of loyalty and care are relatively slight. In contrast, trusts need substantial discretionary powers and acts to trust property in order to perform their functions, and their functions cannot be set in advance with specificity, especially when they are long term. Furthermore, beneficiaries usually do not choose their trustees and are locked into the relationship unless the power of removal is reserved to them, they cannot remove the trustees except by court order, after a showing of wrongful behaviour. Beneficiaries are able to influence the trustee's decisions and unable to exit the relationships. Therefore, trustees are subject to strict fiduciary duties and active judicial supervision.
to rely on their fiduciaries, indeed the very relationship, must be eliminated during the bargaining. Fiduciary law allows such termination of the relationship with respect to specified transactions with the entrusters’ consent. Therefore, the parties must follow a certain procedure designed to ensure an effective transition from the fiduciary world – in which entrustors are entitled to rely on their fiduciaries – to a contract mode – in which entrustors cannot rely on these fiduciaries. Fiduciaries must put entrusters on notice that, regarding the specified transaction, entrustors are on their own; (2) entrustors must have legal capacity to enter into bargains with their fiduciaries as independent parties; (3) to enable entrustors to make informed decisions, fiduciaries must provide them with information regarding the transaction, especially if the information was acquired in connection with the performance of their services to entrustors. This procedure is, as indeed it should be, mandatory. If this procedure is not followed, it is likely that the entrustee’s will not be legally binding. Courts may refuse to recognize waivers of fiduciary duties when they (1) doubt the quality of entrustors’ consent (especially when given by public entrustors, such as shareholders), (2) find that the parties’ own agreements limit their ability to contract around fiduciary duties; (3) have pacificist concerns that the particular entrustors cannot fidel for themselves; (4) assert their power to classify relationships and determine their legal consequences, and preclude parties from doing so by agreement; (5) recognize the importance of providing society with a legal model of a trust relationship.

FIDUCIARY AND CONTRACT RELATIONSHIPS. Some scholars view fiduciary relationships solely as contracts that involve unusually high costs of specification of the parties’ terms and monitoring of parties’ performance. In their opinion, courts should fill in the gaps in these contracts to reflect the parties’ intent, as, without admitting it, courts actually do (see Maey 1991; Easterbrook and Fischel 1993). These scholars hold that a quantum of trust exists as a concept of contracts (consensual relationships) to a legal concept of contracts, subsume fiduciary law into contract law (see Easterbrook and Fischel 1993; see Reinstein 1993) and eradicate its property law underpinning (see Langhein 1995). While economics-based explanations of fiduciary relationships are extremely helpful to the understanding of the law, legal classification of lawfully consensual arrangements as exclusive contracts is unwarranted. Eliminating fiduciary law as a separate category and its reclassification as contract has far-reaching consequences in the context of the Anglo-American legal system. First, reclassification obliterates the historic building block of fiduciary law, that is, trust law. It is a unique invention of English judges, splitting property rights into legal title – held by the trustee, and beneficial interests – held by beneficiaries. The market place in the trustee can deal with trust property as if he were its owner; towards his beneficiaries, he must abide by the terms that he agreed to follow. This dualism allows the parties to limit the trustee’s use of entrusted property, and avoid chaotic property law by maintaining traditional standard forms of ownership. Second, denying the property aspects of fiduciary law dilutes the rights of beneficial owners against their trustees and eliminates the remedy of accounting for breach of fiduciary duties. Conversion of trust assets would constitute a breach of contract (resulting in payment of damages). This result weakens beneficial property rights considerably. Third, judicial discretion in designating the parties’ duties under contract law is far more limited than under fiduciary law. American judges exercise self-restraint in interpreting and creating contract-based duties, especially preventive duties. Fiduciary duties would be derived from the express or implied terms of contracts, leaving entrustee the burden of showing contract-based duties. Fourth, the contract regime would require courts to enforce entrustee’s waivers of fiduciary duties without added protections. Fifth, many current fiduciary relationships might not constitute contracts; unless they find a new home, they remain without legal enforcement altogether.

The contract regime does govern fiduciary relationships in civil law systems (e.g., the German and French legal systems). However, contract in civil law and contract in Anglo-American law differs. Civil law does not recognize the concept of beneficial ownership, but has adapted the reach of contract law to include many types of fiduciary relationships. Civil law judges exercise broad discretion in interpreting the duties of contract parties, including their duty of ‘fair dealing’, and have developed under this heading duties akin to fiduciary duties (see Schetsinger, Blaude, Danuska and Herogen 1989; 1988). Fiduciary relationships are consensual, but they are not necessarily contractual. For example, if, upon my request, my friend accepts $50 in order to buy me flowers, he is my agent and fiduciary. He cannot buy flowers for $40 and pocket the difference without my informed consent. He is not entitled to compensation for his services unless I agreed to pay him, or unless he could claim under the equitable doctrine of quantum meruit. Further, even without compensation, my friend would violate his fiduciary duty to receive money for other purposes or to lose the money negligently.

Although some contract situations (such as franchises, insurance, securities, grants of exclusive contracts, long-term agreements) pose problems similar to those of fiduciary relationships, and may overlap with them in the fringe, the basic prototypes of these relationships differ. The distinctions do not preclude existing fiduciary and contract relationships, such as directors contracting with their corporations, except that if the two conflict, fiduciary law would trump contract.

Arguably, fiduciary duties and remedies may deter fiduciaries, such as corporate directors, from serving. Even so, courts can relax the duties and reduce the severity of the remedies; legislatures may do so and cap awards of damages. The problem does not call for the drastic solution of eliminating fiduciary law altogether. Such a solution may deter entrustees from entering into the relationship, and that may be socially more harmful. Thus far, American courts have refused to sweep fiduciary duties under the contract rug. Some decisions have tended to limit the reach of fiduciary duties, and others expanded the reach of fiduciary law by conveying aspect
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of contract into property. The United States Supreme Court ordered a Central Intelligence Agency employee, who violated his contract with the Government by publishing a book about the Agency without pre-clearance, to account to the Government for his profits from the publication. The Court characterized the information in the book as the Government’s property and ordered accounting, even though the information was public, and the Government failed to prove injury (see Snapp v. United States). Hence, it is highly unlikely that fiduciary law will soon disappear into the contract category.

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See also AGENCY COSTS AND CORPORATE GOVERNANCE; BOARD OF DIRECTORS; CORPORATE CRIME AND ITS CONTROL; CORPORATE LAW; EQUITY; FRAUD ON THE MARKET; INSURANCE LAW; PARTNERSHIP; SECURITIES REGULATION.

Subject classification: 46n(i); 56a(i); 5g(a).


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financial holding companies. See REGULATION OF FINANCIAL HOLDING COMPANIES.

fine print. See STANDARD FORM CONTRACTS.

first, role of. See COMING TO THE NUBIAN.

first possession. First possession has been the dominant method of establishing property rights (Einstein 1979; Berger 1985; Bone 1983). This rule grants an ownership claim to the party that gains control before any other potential claimant. First possession is both more prolific and more viable than suggested by the exotic treasure trove and wild animal cases that typically come to mind. In fact, first possession has been applied widely in both common and statute law in such varied settings as abandoned property, adverse possession, bona fide purchaser, fisheries and wildlife, groundwater, intellectual property, land, bankruptcy debt collection, monies, real estate law, etc. The rule of first possession holds in a diverse array of contexts, including desert so-called treasure trove, and real property law. First possession is also a powerful norm (Eckstein 1991) tightly woven into the fabric of Anglo-American society, where it is better known as "finders keepers" or "first come, first served", in cases ranging from street parking and cafe seating to setting up fishing huts on frozen lakes. First possession has also been a fundamental component of civil law, traditional African and Islamic legal systems, as well as informal and customary rule-making around the world (Lawton 1975; Dukeren and Krier 1993). Indeed, the application of first-possession rules touches upon important issues in law and economics such as the rate of transaction costs in shaping legal institutions, the interactions between private contracting and government action, and the relative efficiency of common law, custom, and codes. Perhaps just as important, rules of first possession are intimately related to the "justice of acquisition", a major topic in philosophical and political discussions of distributive justice (Noltick 1974).