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The Weakening of Fiduciary Law

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Research Handbook on Fiduciary Law

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17. The weakening of fiduciary law

*Andrew F. Tuch**

I. INTRODUCTION

In the 1970s and 1980s, as major financial institutions grew and diversified their operations, US courts and scholars observed that fiduciary law posed profound challenges for the organizational practices of these firms. They acknowledged the possibility, even the inevitability, that large-scale financial conglomerates would face conflicts of duty and conflicts of interest.[1] For instance, thanks to their widening activities, firms found themselves obliged under agency law to disclose information in their possession to clients even when doing so violated duties of confidence to other clients—giving rise to conflicts of duties. Firms also began to participate directly in transactions involving their clients, creating conflicts between firms' financial interests and fiduciary duties to clients—producing conflicts of interest. To address conflicts of duties and interests, firms used various measures, both contractual (such as exclusion clauses) and structural (such as information barriers), but none were generally considered sufficient to provide the level of assurance that firms sought.[2] Financial conglomerates were thus tangled in a web of conflicting duties and interests. Some saw in these fiduciary dilemmas[3] an existential problem: firms, ultimately, would need

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1 Conflicts of duty (also described as conflicts between duties or duty-duty conflicts) are conflicts between the duties that a fiduciary may owe simultaneously to multiple principals. Conflicts of interest (also described as conflicts between duty and interest or duty-interest conflicts) are conflicts between a fiduciary's duty and its self-interest. The distinction, though blurred in practice, is routinely drawn in English and Australian law. *See, e.g.*, MATTHEW CONAGLEN, FIDUCIARY LOYALTY: PROTECTING THE DUE PERFORMANCE OF NON-FIDUCIARY DUTIES 143 (2011); Joshua Getzler, *Ascribing and Limiting Fiduciary Obligations: Understanding the Operation of Consent*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 39, 41–2 (Andrew S. Gold & Paul B. Miller eds., 2014). Although US courts primarily focus on conflicts between duty and interest, scholars occasionally also examine conflicts of duty specifically. *See, e.g.*, Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U. L. REV. 75 (2004).

2 *See infra* notes 31–40 and accompanying text.

3 When acting as advisers, financial conglomerates and other actors may receive payments, or kickbacks, from third parties that may skew their advice to clients. Professor Howell Jackson refers to these arrangements as the "trilateral dilemma." *See* Howell E. Jackson, *The Trilateral Dilemma in Financial Regulation*, *in* OVERCOMING THE SAVINGS SLUMP 82 (Annamaria Lusardi

to slim down their operations, perhaps even to disaggregate, to avoid fiduciary liability.[4]

Financial conglomerates in the UK faced similar challenges under fiduciary law after the "Big Bang" financial reforms in the 1980s. Tasked specifically with addressing these challenges, the Law Commission in 1992 observed that firm structure and the rigors of fiduciary law often gave rise to conflicts.[5] The issues that financial conglomerates faced stemming from fiduciary law could not be easily dismissed; to the Law Commission, they were "wide-ranging"[6] and went "to the core of the structure of the financial markets."[7] Consistent with scholarly and judicial assessments in the US, the Commission cast doubt on the legal effectiveness of the contractual and structural measures that UK firms used to attempt to avoid breaching their obligations.[8]

In neither the US nor the UK, however, have lawmakers ever explicitly confronted the challenges that fiduciary law poses for financial conglomerates. One might therefore predict that these firms—exposed to equity's severe gain-stripping and other remedies—would have reduced their scale or scope of operations, otherwise reduced the possibility of conflicts, or at least been cautious in their growth. However, since these legal challenges were broadly recognized from the 1970s through the 1990s, financial conglomerates have grown massively, significantly increasing the possibilities for conflicts, particularly conflicts of interest, due to their increasing focus on having a direct financial interest in transactions.[9] How were financial conglomerates able to continue growing and diversifying despite the imposition of fiduciary constraints generally seen as robust?

I examine this question, focusing on US and UK law. I consider potential explanations including the erosion of fiduciary duties by contract, regulators' and courts' legitimation of information barriers as checks on conflicts, the implicit modification of fiduciary principles by regulation, clients' non-enforcement of fiduciary duties, and the arbitration (as opposed to litigation) of client disputes. I generally reject the view that the erosion of fiduciary law by contract law explains apparent weaknesses in the practical effect of fiduciary doctrine, at least in the US, and instead point to more pragmatic reasons. In particular, I highlight factors that may inhibit parties from enforcing fiduciary duties, including the mandated use of arbitration to resolve disputes.

I seek to explain these developments, rather than to assess their desirability. An assessment of their desirability would require evidence on the harms created by

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ed., 2008). To the extent that these arrangements violate firms' fiduciary duties, they may exacerbate the fiduciary dilemmas described in this chapter.

[4] *See infra* note 41 and accompanying text.

[5] LAW COMMISSION, FIDUCIARY DUTIES AND REGULATORY RULES, 1992, CONSULTATION PAPER 124, at 31–9 (U.K.). The Law Commission prepares detailed reports to advise UK Parliament on potential reforms to law.

[6] *See id.* at 226.

[7] *See id.* at 7. Although the Commission suggested that problems of mismatches between fiduciary duty and regulatory rule "might not be large," *id.* at 7, it noted that these problems occurred "in significant categories of cases." *Id.* at 221.

[8] *See infra* notes 36–40 and accompanying text.

[9] *See infra* notes 42–48 and accompanying text.

conflicts, the deficiencies of existing regulation, and the costs and benefits of possible reforms. Distinct analysis would be required for each jurisdiction. Instead, by examining factors that may explain the increasing scale and scope of these firms despite the imposition of fiduciary constraints generally seen as robust, I seek to contribute to our understanding of the practical force of fiduciary law, in addition to its doctrinal formulation and differences across jurisdictions. I engage with scholarship that has observed the diminished force of fiduciary law,[10] focusing especially on explanations concerning the enforcement of fiduciary duties.

II. THE FIDUCIARY DILEMMAS OF FINANCIAL CONGLOMERATION

Financial conglomerates face fiduciary dilemmas because of the range of activities they perform and because of the way fiduciary law generally, and agency doctrine specifically, operates. First, these firms act simultaneously for multiple clients and often also act as principals, even in transactions in which they act for clients.[11] Second, in acting for clients, financial conglomerates are often fiduciaries. When they act as investment advisers, they are fiduciaries under the Investment Advisers Act of 1940[12] and often also under the common law of agency or trust law.[13] When they act as broker-dealers, they may be fiduciaries, particularly if they manage discretionary accounts or exercise control over customer assets.[14] They may be fiduciaries when they advise on merger and acquisition (M&A) transactions[15] or underwrite securities offerings.[16]

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[10] *See, e.g.*, Joshua Getzler, *Financial Crisis and the Decline of Fiduciary Law*, *in* CAPITAL FAILURE: REBUILDING TRUST IN FINANCIAL SERVICES 193 (Nicholas Morris & David Vines eds., 2014).

[11] As to the organizational structure of these firms, see Andrew F. Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563, 570–72 (2014).

[12] Section 206(1)–(2).

[13] *See* Deborah A. DeMott & Arthur B. Laby, *The United States of America*, *in* LIABILITY OF ASSET MANAGERS 411, 415 (Danny Busch & Deborah A. DeMott eds., 2012). As investment advisers, financial conglomerates—or their relevant entities—thus often owe both statutory and common law fiduciary duties.

[14] *See* SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS: AS REQUIRED BY SECTION 913 OF THE DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 50–73 (Jan. 2011).

[15] *See, e.g.*, Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Sec. Corp., 351 F. Supp. 2d 79, 102 (S.D.N.Y. 2004) (stating that the relationship between an M&A adviser and its corporate client may be fiduciary even where no formal agency relationship exists, observing that New York courts have found such relationships to be fiduciary, and finding that the M&A adviser in question "owed a fiduciary duty to [its corporate client] in its capacities as investment banker and financial advisor"); Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079 (2016).

[16] *See* EBC I, Inc. v. Goldman Sachs & Co., 5 N.Y.3d 11, 21–2 (2005) (recognizing that an underwriter may be a fiduciary of its client to the extent of "the underwriter's role as advisor."), Andrew F. Tuch, *Securities Underwriters in Public Capital Markets: The Existence, Parameters*

Third, fiduciary law is onerous. As classically formulated, it requires fiduciaries to act with undivided loyalty and to eschew conflicts of duty and conflicts of interest without proper authorization. "Not only must the fiduciary avoid, without informed consent, placing himself in a position of conflict between duty and personal interest, but he must eschew conflicting engagements."[17] Fiduciary law evolved in an era before the rise of large multi-function firms.[18] The principles of agency law are formulated without regard to the possibility of firms structured as financial conglomerates.[19]

In the US, under basic agency principles, a single firm may simultaneously owe conflicting, or incompatible, duties, with the result that it must either cease to act or risk violating one of its duties.[20] While the variety of fact patterns in which agency duties may arise makes it difficult to generalize about conflicts of duties,[21] a well-recognized instance of a conflict of duties occurs because information possessed by individuals in one part of an entity is, under agency law, attributed to the entity generally. A firm may be duty-bound to disclose material information in its possession to a client,[22] while also duty-bound to another client to keep that information confidential.[23] A firm may thus be stuck between a rock and a hard place: it must

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and Consequences of the Fiduciary Obligation to Avoid Conflicts, 7 J. CORP. L. STUD. 51 (2007) (arguing that underwriters, as advisers, may have fact-based fiduciary relationships with their clients).

17 Commonwealth Bank of Australia v. Smith (1991) 42 FCR 390, 392 (cited with approval in England in Bristol & West Building Society v. May May & Merrimans [1996] 2 All E.R. 801, 815 (Ch.D). To similar effect, see Dabney v. Chase Nat. Bank of City of N.Y., 196 F.2d 668, 670 (2d Cir. 1952) ("It is a part of [the fiduciary's] obligation to give his beneficiary his undivided loyalty, free from any conflicting personal interest.").

18 *See* Ross Cranston, *Insider Dealing—Informational Imbalances and Financial Businesses, in* EUROPEAN INSIDER DEALING 203, 210 (Klaus J. Hopt & Eddy Wymeersch eds., 1991).

19 *See* RESTATEMENT (THIRD) OF AGENCY 6 (2006) ("Doctrines within the common law of agency are formulated without regard to whether a person is an individual or a legal or commercial entity or other legally recognized nonindividual person, including an organization.").

20 *See* Martin Lipton & Robert B. Mazur, *The Chinese Wall Solution to the Conflict Problems of Securities Firms*, 50 N.Y.U. L. REV. 459 (1975); HARRY MCVEA, FINANCIAL CONGLOMERATES AND THE CHINESE WALL: REGULATING CONFLICTS OF INTEREST (1993); Note, *Conflicting Duties of Brokerage Firms*, 88 HARV. L. REV. 396 (1974); Norman S. Poser, *Chinese Wall or Emperor's New Clothes? Regulating Conflicts of Interest of Securities Firms in the U.S. and the U.K.*, 9 MICH. Y.B. INT'L LEGAL STUD. 91, 93 (1988); Larry L. Varn, *The Multi-Service Securities Firm and the Chinese Wall: A New Look in the Light of the Federal Securities Code*, 63 NEB. L. REV. 197 (1984).

21 Noting the "multifarious possibilities of conflict of obligation or interest" that arise in financial conglomerates, the SEC warned of the dangers of generalizing "as to the problems presented or possible remedies." REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 88-95, pt. 5, at 65 (1963).

22 *See* RESTATEMENT (SECOND) OF AGENCY § 381 (1958); RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006). The so-called "shingle theory" of federal securities regulation may also provide a basis for requiring financial conglomerates to disclose information to clients when acting as broker-dealers.

23 *See* RESTATEMENT (THIRD) OF AGENCY § 8.05 (2006).

determine which duty to breach or which client to cease serving or, perhaps, ultimately, which function to stop providing.[24]

The quintessential instance of conflicting duties occurs when a firm acquires non-public information from an investment-banking client while also advising a brokerage client on acquiring stock in that investment-banking client. Disclosing to the brokerage client that the investment-banking client will shortly announce material information, such as an M&A deal or securities offering, would violate a duty of confidence to the latter client (as well as anti-fraud provisions of federal securities laws), and yet failing to do so may violate a duty of disclosure to the former client.

In *Black v. Shearson Hammill & Co.*,[25] an early decision illustrating the rigors of fiduciary doctrine, a California state court refused to relieve a broker of his duty of disclosure to a client even though that duty conflicted with a duty of confidence the broker owed to another party. The court explained:

> [W]e have been given no sufficient reason for permitting a person to avoid one fiduciary obligation by accepting another which conflicts with it. ... The [fiduciary's] conflict in duties is the classic problem encountered by one who serves two masters. It should not be resolved by weighing the conflicting duties; it should be avoided in advance ... or terminated when it appears.[26]

In other settings in which financial conglomerates operate, courts have recognized fiduciary obligations even when doing so put firms in positions of conflicting duties. For example, in *Morris v. Resolution Trust Corp.*, the court described a firm's defense as "suffer[ing] from the fallacy of the false alternative" since the firm could have avoided the conflicting duties by declining to perform one of the roles.[27]

Firms may also face conflicts of interest.[28] A firm may face this type of conflict where it is a fiduciary of one client and yet has financial incentives that conflict with its duties in that relationship. The quintessential case involves a firm taking a position in securities through its proprietary trading operations that undermines its incentives to loyally serve a client's interests.

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[24] *See, e.g.*, Black v. Shearson, Hammill & Co., 72 Cal. Rptr. 157 (Ct. App. 1968); Slade v. Shearson, Hammill & Co., 517 F.2d 398, 400 (2d Cir. 1974). In Cotton v. Merrill, Lynch, Pierce, Fenner & Smith, 699 F. Supp. 251, 256 (N.D. Okla. 1988), in contrast, the broker was not liable for failing to disclose the non-public information in question; informed by insider trading case law, the court treated the client as having an overriding public duty not to disclose such information "for the clients' benefit in trading securities." Professor Arthur Laby takes a narrow view of *Black* and *Slade* and reconciles them with the approach in *Cotton* by suggesting that the conflict of duties in the earlier two decisions arose because firms had made client recommendations that were at odds with the information they possessed. *See* Laby, *supra* note 1, at 136. Even if this additional element is required for the conflict to occur, it may well occur often enough to make fiduciary dilemmas real if, as seems plausible, firms make recommendations or give advice on securities about which they (or one of their business units) have relevant non-public information.

[25] 72 Cal. Rptr. 157 (Cal. Ct. App. 1968).

[26] *Id.* at 161.

[27] 622 A.2d 708, 712 n.3 (Me. 1993). For a more recent example, see In re Parmalat Sec. Litig., 684 F.Supp.2d 453, 478 (S.D.N.Y. 2010).

[28] As to the meaning of these terms, see *supra* note 1.

A financial conglomerate's organizational structure magnifies the risk that a firm will face conflicts of duty and interest. As early as 1963, the US Securities and Exchange Commission (SEC) recognized the "multifarious possibilities of conflict of obligation or interest in matters large and small" in financial conglomerates.[29] By the 1980s, scholars regarded such conflicts as "endemic" and even as "inescapable" features of financial conglomerates.[30] One court stated that agency doctrine made it "exceedingly difficult" for a single firm to combine the activities of investment banking and trading.[31] Firms used information barriers to try to avoid fiduciary breaches; these measures were effective in some cases as a defense to insider trading liability (when firms were accused of trading using non-public information from their clients), but they were not generally sufficient to answer the dilemmas created by fiduciary law outside the insider trading context.[32]

In the UK, too, scholars and others recognized the dilemmas posed by fiduciary law for financial conglomerates.[33] The Law Commission in its 1992 consultation report regarded conflicts of duty and interest as "inevitable," given the multiple capacities in which financial conglomerates act.[34] Another commentator observed that "the very bedrock of [English] fiduciary law ... is compromised by multi-service financial conglomerates, which, by their very nature, function within the context of conflicting duties."[35] The Law Commission also specifically considered whether either information barriers (then known as Chinese walls) or contractual provisions might resolve or otherwise mitigate these fiduciary dilemmas for financial conglomerates.[36] Consistent with the US position, the Law Commission rejected information barriers as a solution (while still acknowledging their effectiveness for other purposes, such as preventing violations of insider trading law). It concluded that "at bottom the Chinese wall will not work as a matter of private law"[37] and that this structural measure "does not afford the

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29 *See* REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 88-95, pt. 5, at 65 (1963) (the Securities and Exchange Commission (SEC) recognized the "multifarious possibilities of conflict of obligation or interest in matters large and small").

30 *See* Poser, *supra* note 20, at 95 ("[C]onflicts of interest and of duty ... are endemic to a multi-service firm."); INST. OF BANKERS, CONFLICTS OF INTEREST IN THE CHANGING FINANCIAL WORLD xv (Roy M. Goode ed., 1986) (discussing the "inescapable" existence of conflicts of interest in financial conglomerates); Roy A. Schotland, *Introduction, in* ABUSE ON WALL STREET: CONFLICTS OF INTEREST IN THE SECURITIES MARKETS 3, 6 (Twentieth Century Fund, 1980) (financial conglomerates "are inescapably enmeshed in a maze of conflicting obligations").

31 Slade v. Shearson, Hammill & Co., 517 F.2d 398, 400 (2d Cir. 1974).

32 Poser, *supra* note 20, at 103–13. *See also Conflicts of Interest and the Regulation of Securities: A Panel Discussion*, BUS. LAW. 545, 549 (Jan. 1973) (raising doubts about the legal sufficiency of information barriers to address financial conglomerates' inconsistent fiduciary duties); *id.* at 572 (observing that the information barrier "flies in the face of the rules relating to imputed knowledge.").

33 *See* Law Commission, *supra* note 5, at 232–40.

34 *Id.* at 61.

35 MCVEA, *supra* note 20, at 39.

36 Law Commission, *supra* note 5, at 61-163.

37 *Id.* at 222.

type of protection that is needed for a firm to carry on its functions with the degree of assurance that the wall is designed to provide."[38] The Commission also questioned the effectiveness of contractual techniques (such as exclusion clauses disclaiming the existence of fiduciary duties) for addressing these fiduciary dilemmas, concluding that they "cannot ... safely be relied upon"[39] and "are not effective, or at least there is considerable uncertainty about their efficacy."[40]

Given that increasing the scale and scope of a firm's operations magnifies the risk of conflicts, doubt must have existed about the capacity for these firms to continue growing. Indeed, some doubted whether these firms could even continue in their current organizational form given the robust limits imposed by fiduciary law. One commentator at the time observed that a strict interpretation of fiduciary law "would make it difficult if not impossible for a multi-service securities firm to pursue its normal activities."[41] At the least, fiduciary law would have been expected to act as a brake on firm growth, preventing firms from taking on additional engagements or areas of service that would involve them in further conflicts of duty and/or interest.

III. THE GROWTH AND DIVERSIFICATION OF FINANCIAL CONGLOMERATES

In the 1980s, however, when the constraints of fiduciary law for major financial conglomerates were well recognized, these firms—primarily investment and commercial banks—began expanding and diversifying their operations. Between 1984 and 2008, the average size of US banks, measured in assets, increased five-fold.[42] Investment banks ventured beyond their traditional activities, moving into private equity investing[43] and offering bridge loans to buyers in M&A transactions.[44] They focused increasingly on trading and investing with their own funds.[45] They did so *as principals*, either exclusively or by co-investing with other market participants, often their clients.[46] Similar changes occurred at commercial banks, which aggressively

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38 *Id.* at 161.

39 *Id.* at 8.

40 *Id.* at 10.

41 Poser, *supra* note 20, at 101.

42 *See* David C. Wheelock & Paul W. Wilson, *Do Large Banks Have Lower Costs? New Estimates of Returns to Scale for US Banks*, Federal Reserve Bank of St. Louis Working Paper 1 (2009), available at https://research.stlouisfed.org/wp/2009/2009-054.pdf, last accessed August 3. 2017.

43 *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, Vol III, 111-12 (2002).

44 *See id.* at 112.

45 *See* FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 66 (2011).

46 *See* Philip Augar, *Do Not Exaggerate Investment Banking's Death*, FIN. TIMES, Sept. 22, 2008 (In the decade before the Financial Crisis of 2007–09, "advising clients on corporate finance and investment matters [was] subsumed in a dash for profit involving principal investing

ventured into activities formerly within the exclusive domain of investment banks,[47] aided by lenient judicial and regulatory interpretations of the Glass-Steagall Act. As firms grew, the industry consolidated, producing "fewer and fewer, but larger and larger, financial institutions."[48] By 2007, the industry consisted of "a handful of megabanks" with wide-ranging financial operations.[49]

The impetus for growth may have been provided by the quest for economies of scale and scope, for market power, and perhaps even for "too big to fail" status.[50] Managerial self-interest may also have been at work.[51] The phenomenon is nevertheless puzzling given fiduciary constraints generally seen as robust and the legal insufficiency of contractual and structural measures to satisfy fiduciary duties. There is also no indication that firms were measured in their growth, that they confronted these legal challenges by acting for clients more selectively or acting less often in multiple capacities, in order to minimize the risk of fiduciary liability. Rather, financial conglomerates' increasing focus on trading and investing *as principals*, while simultaneously acting as agents, would suggest the opposite. Fiduciary law failed to have the predicted effect of restraining firms from taking actions that multiplied their conflicts, actions that exacerbated the challenges posed by fiduciary law. Why did fiduciary law respond so weakly?

IV. POTENTIAL EXPLANATIONS

(a) The Erosion of Fiduciary Principle by Contract

One plausible explanation is that since firms' fiduciary dilemmas were broadly recognized in the 1980s and early 1990s, contract effectively eroded fiduciary doctrine, weakening its practical effect. If courts adopted a less strict view of fiduciary law by permitting contract to vary or exclude fiduciary duties, fiduciary law would have posed a weaker constraint on financial conglomerates' growth. Professor Joshua Getzler observes a "steep reduction in the incidence and intensity of fiduciary duties" beginning in the mid-1980s under both US and English law.[52] Professor Getzler points

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and proprietary trading."). Investment banks often co-invested with clients through their asset management operations.

[47] *See* SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 64, 82 (2010).

[48] *Id.* at 59.

[49] *Id.* at 86. *See also id.* 82–7; 153–88.

[50] *See* Arthur E. Wilmarth, Jr., *The Transformation of the Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, U. ILL. L. REV. 215, 279–311 (2002). It could also be that these various benefits outweighed what financial conglomerates would have had to pay in litigation judgments, settlements, and arbitration awards—even if the fiduciary duty were completely enforceable and regularly enforced.

[51] *Id.*

[52] Getzler, *supra* note 10, at 200.

in the US to the "shift in the intellectual commitments of the legal caste,"[53] a reference to the inclination of American scholars to see fiduciary duties through an economic lens and regard them as gap-filling terms in incomplete contracts and in the UK to the willingness of courts to permit parties to contractually narrow the scope of fiduciary duties or to exclude them entirely.[54]

In the US, it is less than clear that the contractual erosion of fiduciary law explains weaknesses in the practical effect of fiduciary law. Although the contractarian approach has become a pervasive influence in scholarly analysis of fiduciary doctrine and has influenced certain judges,[55] it is not a mainstream view among judges generally.[56] Courts still identify fact-based fiduciary relationships using indicia such as trust and confidence, rather than by employing an explicitly contractarian approach.[57]

Many courts do respect the capacity of sophisticated parties to explicitly disclaim or exclude fiduciary duties,[58] but there are important limits. Agency law in particular has retained a robust attitude toward fiduciary disclaimers. In determining the effect of these provisions, courts focus on whether a relationship is one of agency (and therefore fiduciary), a question that turns on whether the common law definition of agency is met—whether, as Section 1.01 of the Restatement (Third) of Agency requires, both parties to a relationship manifest assent that one person shall act on behalf of and subject to the control of the other person.[59] How parties themselves characterize their relationship is not controlling.[60] In fact, the Restatement (Third) of Agency arguably

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[53] *Id.* at 200–201. Although less relevant for the current argument, Professor Getzler also points to the expected adoption in many states in the 1990s of the Uniform Prudent Investor Act, which reformed trust investment law to reflect insights from modern portfolio theory. *See id.*

[54] *Id.* at 201–4.

[55] *See, e.g.*, Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987), *cert. dismissed*, 108 S. Ct. 1067 (1988) (referring to the fiduciary obligation as "a standby or off-the-rack guess about what parties would agree to if they dickered about the subject explicitly").

[56] For example, extra-judicial writing of members of the Delaware judiciary reflects an understanding of fiduciary doctrine more in-line with classical views. *E.g.*, Leo E. Strine & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS (Robert W. Hillman & Mark J. Lowenstein eds., 2015).

[57] *See, e.g.*, EBC I, Inc. v. Goldman Sachs & Co., 5 N.Y.3d 11, 799 N.Y.S.2d 170 (2005).

[58] *See, e.g.*, Valentini v. Citigroup, 837 F. Supp. 2d 304, 326 (S.D.N.Y. 2011) (applying New York law); LBBW Luxemburg, S.A. v. Wells Fargo Securities LLC, 10 F.Supp. 3d 504 (S.D.N.Y. 2014) (same). *But compare* In re Merrill Lynch Auction Rate Securities Litigation 758 F.Supp. 2d. 264, 282 (S.D.N.Y. 2010) (ruling under Louisiana law that "it is the facts and circumstances of the relationship of the parties that governs whether a [fiduciary] duty existed," not how the parties characterize the relationship themselves).

[59] *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006). *See also* DeMott & Laby, *supra* note 13, at 450–51 (discussing limits on the efficacy of exculpatory language under common law).

[60] *See id.* § 1.02. For further discussion of the effect of parties' own characterization of their relationship on the existence of an agency relationship, see Deborah A. DeMott, *Defining Agency and Its Scope*, *in* COMPARATIVE CONTRACT LAW: A TALE OF TWO LEGAL SYSTEMS 23–25 (Martin Hogg & Larry A. DiMatteo eds., 2015). Fiduciary disclaimers may fail to prevent fiduciary duties from arising in non-agency fiduciary contexts. *See, e.g.*, Ha-Lo Indus., Inc. v.

takes a stronger line than its predecessor, published in 1958, on the capacity of parties to contract out of fiduciary duties by excluding the proviso "unless otherwise agreed" in stating an agent's general duty of loyalty.[61]

There are other indications that fiduciary law has retained its vigor. Courts have taken a narrow view of the effect of informed consent in relieving fiduciaries of the duties they owe. For example, in *Rural Metro*,[62] a financial conglomerate argued that a generalized disclosure provision in its client engagement letter amounted to informed consent by the client to a particular conflict of interest; the provision warned that the firm could have conflicts with its client because of the firm's wide-ranging functions.[63] The court suggested that the provision lacked specificity, explaining that the firm should have "disclos[ed] the conflict and its import" in order to avoid "what in the old days, might have been called constructive fraud."[64]

In contrast, English courts have become more willing to permit parties to contractually exclude, modify, or otherwise defeat fiduciary protections. Shortly after the Law Commission's 1992 report studying the fiduciary dilemmas facing financial conglomerates, the Privy Council in *Kelly v. Cooper*[65] confirmed the power of agents to vary the scope of fiduciary duties. The Board significantly qualified the possibility that a conflict of duty or interest might arise due to the firm's obligation to use all information in its possession for the benefit of its clients. The plaintiff brought the action against his real estate brokers, the defendants, who had acted for him as he sold his property to a third-party buyer. At the time of the sale, the defendants knew that the buyer had proposed to buy a property adjacent to the plaintiff's because they were acting for the vendor of that property. The defendants failed to tell the plaintiff this, even though it was allegedly material to the price that the plaintiff would have been able to extract from the buyer for his property. The plaintiff claimed that the defendants had breached their fiduciary duties by failing to disclose the buyer's proposal to buy the adjacent property and by putting themselves in a position where their duty to disclose that information conflicted with their self-interest in closing the sale of the plaintiff's property.

Credit Suisse First Bos., Corp., No. 004 C 3163, 2005 WL 2592495, at *5–6 (N.D. Ill. Oct. 12, 2005) (denying a motion for summary judgment that claimed that a fiduciary disclaimer in an engagement letter between a bank and its merger and acquisition client prevented the bank from owing fiduciary duties to its client); In re Merrill Lynch Auction Rate Securities Litigation, 758 F.Supp.2d 264, 282 (S.D.N.Y. 2010) (treating a disclaimer that the "[bank is] acting solely in the manner of an arm's length counterparty and not in the capacity of your financial advisor or fiduciary" as *ineffective* in preventing fiduciary duties from arising because the provision post-dated the conduct alleged to give rise to fiduciary relations and because "in any event, it is the facts and circumstances of the relationship of the parties that governs whether a [fiduciary] duty existed.").

[61] The Restatement (Second) of Agency qualifies its statement of the agent's general duty of loyalty with the words "unless otherwise agreed," suggesting that the parties' agreement controls the existence of such a duty. *See* RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

[62] In re Rural Metro Corp. Stockholders Litig., 88 A.3d 54 (Del. Ch. 2014).

[63] *Id.* at 101.

[64] *Id.* (quoting Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1068 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005)).

[65] [1993] A.C. 205.

The Privy Council defined the scope of the defendant brokers' fiduciary duties by the explicit and implicit terms of the brokers' contract of agency with the plaintiff. Delivering the opinion of the Board, Lord Browne-Wilkinson opined that "in the present case, the scope of the fiduciary duties owed by the defendants to the plaintiff (and in particular the alleged duty not to put themselves in a position where their duty and their interest conflicted) are to be defined by the terms of the contract of agency."[66] Because the plaintiff was "well aware" that the agent acted for multiple vendors and would receive confidential information from them in doing so, the Board implied a term entitling the agent to act for multiple vendors without having to disclose confidential information given by one vendor for the benefit of another.[67] Thus, the defendants did not breach any duty by failing to disclose the buyers' proposed acquisition of the adjacent property. Moreover, no conflict between duty and interest arose, because the contract "envisaged that they might have such a conflict of interest."[68] The case thus made clear that fiduciary law may not create problems for firms where the contract between parties varies the fiduciary's duties—either impliedly, based on a client's knowledge of the fiduciary's potential competing interests, or explicitly. Indeed, *Kelly* led the Law Commission to revise its 1992 view to opine that contractual techniques "can go a long way" toward addressing problems created by fiduciary doctrine for financial conglomerates.[69]

At the same time, this permissive judicial approach toward varying fiduciary duties does not completely explain weaknesses in the practical effect of fiduciary law in the UK. First, contractual techniques depend on client agreement, which it cannot be assumed that all clients will give. Second, *Kelly* did not address all manifestations of the fiduciary dilemma. For instance, it did not relieve fiduciaries of obligations where they acted for multiple clients *in the same transaction* (in *Kelly*, the fiduciary had acted for the other client in distinct transactions) and arguably offered no relief for conflicts between duty and self-interest that were more acute than that occurring in *Kelly*, such as where a fiduciary has a direct beneficial interest in a transaction.[70] In either of these situations, courts might not imply terms in contracts to modify the fiduciary duties that would otherwise arise, requiring express provision in contractual terms or informed consent.[71] Scholars have suggested other limits on *Kelly*, with Professor Francis

[66] *Id.* at 215.

[67] *Id.* The Privy Council suggests its analysis would also apply to stockbrokers (known in the US as broker-dealers) because of their role in acting for multiple principals. *Id.* at 214.

[68] *Id.* at 215.

[69] Law Commission, Fiduciary Duties and Regulatory Rules: Report on a Reference Under Section 3(1)(e) of the Law Commission Act 1965 (1995), at 70 [hereinafter, 1995 Law Commission Report] (such techniques "can go a long way towards avoiding any problems which might be caused by mismatch between fiduciary duties and what is required or permitted by regulatory rules").

[70] *See* 1995 Law Commission Report, *supra* note 69, at 24, 77–8. The Commission gave as an example the situation where the fiduciary sells its own land to its client. *Id.* at 24.

[71] 1995 Law Commission Report, *supra* note 69, at 24, 85.

Reynolds for example regarding the reasoning as not "appropriate to agency law in general" and the decision as confined to its own facts.[72]

In a decision reflecting the limits of *Kelly*, the House of Lords in *Hilton v. Barker Booth & Eastwood*[73] examined the conduct of a law firm that had acted for both parties *in a single transaction*, with their consent, but had failed to disclose information relevant to one of the parties, including their (the law firm's) direct interest in the other side of the deal.[74] Lord Walker rejected the notion that the client in question had impliedly consented to the conflict, even though the client knew the firm acted for another participant in the deal.[75] Rather, the fiduciary owed irreconcilable duties since it was duty bound to disclose information to one client when doing so would have breached a duty to another client in the transaction to protect that information from disclosure.[76] The fiduciary was liable for failing to disclose the information to its client.

A third factor establishing that the permissive approach allowing variation in fiduciary duties did not completely resolve the fiduciary dilemmas for firms under English law is that limits existed on the ability of firms to disclaim the very existence of fiduciary duties—rather than simply varying their content or scope. Indeed, in its 1992 consultation paper the Law Commission regarded declarations as to the nature of the relationship—for example, terms that a firm is *not* a fiduciary or agent—as inconclusive.[77] Broadly mirroring the approach later expressed in the Restatement (Third) of Agency,[78] the nature of the relationship had to be determined according to "the entirety of the obligations undertaken by a firm and the reality of the relationship between it and the customer."[79] Thus, contractual terms disclaiming fiduciary duties were not automatically read to have their purported effect.

In 2007, however, courts applied a significantly more permissive approach toward the disclaimer of fiduciary duties. By this time, of course, financial conglomerates had already significantly increased their scale and scope. In *ASIC v. Citigroup*,[80] a landmark Australian decision considered influential in the UK,[81] the Federal Court of Australia

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72 F.M.B. Reynolds, *Agency*, J BUS. L. 144, 149 (1994) ("[S]uch reasoning cannot be appropriate to agency law in general. ... [T]his case should not be taken as more than a decision on its facts."). *See also* Alistair Alcock, *Limited Fiduciary Duties in the City*, *in* THE REALM OF COMPANY LAW 81, 86–7 (Barry A.K. Rider ed., 1998) (also suggesting limits).

73 [2005] 1 W.L.R. 567 (H.L.).

74 *See also* Joshua Getzler, *Inconsistent Fiduciary Duties and Implied Consent*, 122 L.Q.R. 1, 7–8 (2006) (describing the decision as standing in opposition to "the tide of decisions diluting fiduciary law in England").

75 *Supra* note 73, at 578.

76 *Id.* at 577–80. The duties in question arose under the common law, rather than under rules of a bar association or other professional body.

77 *See* Law Commission, *supra* note 5, at 86.

78 *See supra* note 60 and accompanying text.

79 *Supra* note 5, at 87.

80 *See* Australian Sec & Invs Comm'n v Citigroup Glob Mkts Austl Pty Ltd [No. 4] (2007) 160 F.C.R. 35 (Austl.).

81 *Briefing: Contracting Out of a Fiduciary Relationship – Investment Banks and Clients*, FRESHFIELDS BRUCKHAUS DERINGER (Aug. 1, 2007), http://www.lexology.com/library/detail.aspx?g=66db9fee-7a1d-45af-a711-60361d2ed3f5 (https://perma.cc/TJ2W-YL8L), last accessed August 3. 2017.

gave literal effect to an exclusion clause that declared that "the [client's] engagement of [the financial conglomerate] is as an independent contractor and not in any other capacity including as a fiduciary."[82] The court found the clause effective to disclaim the existence of a fiduciary relationship, even though "[b]ut for the express terms of the mandate latter, the pre-contract dealings between [the financial conglomerate and its client] would have pointed strongly toward the existence of a fiduciary relationship in [the financial conglomerate's] role as an advisor."[83] Offering welcome news for financial conglomerates, the court interpreted the provision as meaning what it said. But the court also expressed limits. This permissive approach did not apply where there was fraud or deliberate dereliction of duty or where fiduciary duties pre-existed the parties' contractual dealings.[84] Moreover, informed consent—rather than simple contractual disclaimer—would be required to effectively displace fiduciary obligations in "established" categories of fiduciary relationship,[85] rather than in fact-based or ad hoc relationships such as the one alleged.

Finally, because of limited case law, many questions about the constraints ultimately imposed by fiduciary law in the UK remain unsettled. For example, it is unclear precisely when fiduciary duties may arise between parties before they have finalized contractual relations[86]—an important question considering that engagement letters may not be executed until after a relationship has formed. Uncertainty exists as to the duties that may survive the end of a fiduciary relationship—and thus as to the fiduciary constraints on financial conglomerates acting contrary to the interests of their former clients.[87] Some uncertainty also exists on how the Unfair Contract Terms Act 1977 may limit the force of contractual disclaimers.[88]

In sum, it would seem unlikely that contractual erosion of fiduciary principles explains why fiduciary law failed to respond more forcefully as financial conglomerates grew and diversified in the US.[89] In the UK, the position is more uncertain. Courts there surely adopted a more permissive attitude toward contractual variation of fiduciary duties soon after the fiduciary dilemmas facing financial conglomerates were generally recognized. At the same time, there is doubt as to whether these changes are a completely sufficient response to the dilemmas—because contractual provisions purporting to modify or exclude fiduciary duties have their limits, because those

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[82] Citigroup Glob Mkts Austl (2007) 160 FCR 35 (Austl.) at [145].

[83] *Id.* at [325].

[84] *Id.* at [280]. These limits may apply in England. Other limits might exist due to the statutory regulation of contract terms under the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999.

[85] *Id.* at [305].

[86] *See* Getzler, *supra* note 1, at 54.

[87] *Id.*, at 59.

[88] *See* Christa Band, *Conflicts of Interests in Financial Services and Markets*, 21 J.INTL. BANKING L. & REG. 677, 87 (2007).

[89] But contract has been more effective in eroding fiduciary law under the Employee Retirement Income Security Act of 1974. *See* Peter J. Wiedenbeck, *Untrustworthy: ERISA's Eroded Fiduciary Law*, Washington University in St. Louis Legal Studies Research Paper No. 16-11-01, https://ssrn.com/abstract=2865752, last accessed August 3. 2017.

provisions depend ultimately on the agreement of clients, which cannot be guaranteed, and because legal gaps remain.

(b) The Legal Effectiveness of Information Barriers

Information barriers are self-enforced by firms. They consist of policies and procedures intended to prevent employees in one part of a firm spreading non-public information to employees in other parts of the firm.[90] The policies and procedures are systemic, rather than ad hoc. In practice, information barriers typically consist of the physical separation of workspaces, confidentiality undertakings, education, and training, as well as the separation of data storage, retrieval, and communication systems.[91]

The weakness of fiduciary law as financial conglomerates grew and diversified might be readily explained if courts had begun accepting information barriers as legally effective in avoiding liability for fiduciary breaches. This potential explanation is distinct from whether information barriers serve as a legal defense to liability for insider trading under securities law; they may, and were in fact initially adopted for that purpose.[92] In theory, the information barrier might satisfy fiduciary duties by conceptually carving the firm into multiple, distinct firms, making it possible for a financial conglomerate to reconcile what would otherwise be conflicts of both duties and interests. For instance, the duty of disclosure would require the firm's broker to disclose all material information in possession of the firm's *brokerage unit*, rather than that in possession of the firm as a whole.[93] The firm could thus discharge its duty of disclosure to a brokerage client, or avoid violating that duty, while respecting its duty of confidence to an investment-banking client that had divulged material, non-public information to personnel of another unit of the firm.

In the US, the SEC has never formally endorsed information barriers as legally effective means of avoiding fiduciary breaches, although the regulator acknowledges their usefulness for other purposes, such as avoiding insider trading liability. It had the opportunity to do so in 1974 in *Slade v. Shearson, Hammill & Co*,[94] in which a financial conglomerate possessed "walled off" adverse non-public information about one of its investment-banking clients while its broker-dealers recommended—without disclosing the adverse information—that customers buy securities in that client.[95] Though the court rejected the firm's information barrier defense, the SEC suggested in

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90 For more detail, see Andrew F. Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563 (2014).

91 Self-regulatory organizations have described in broad terms the "minimum elements" for "adequate" information barriers. *See, e.g.*, Nat'l Ass'n of Sec. Dealers & N.Y. Stock Exch., Joint Memorandum on Chinese Wall Policies and Procedures, Notice to Members No. 91-45 (1991) (explaining the "minimum elements" for "adequate" information barriers).

92 *See* MCVEA, *supra* note 20, at 171–8.

93 *See* Slade v. Shearson, Hammill & Co., Inc., 18 Fed.R.Serv.2d 265 (S.D.N.Y. Jan. 2, 1974).

94 *Id.*

95 The district court had certified a question to the Second Circuit, although the case settled before the Second Circuit determined the matter. Slade v. Shearson, Hammill & Co., No. 42 Civ. 4779, 1974 WL 376, at *1 (S.D.N.Y. Mar. 18, 1974).

an amicus curiae brief that information barriers, in combination with so-called "restricted lists," would have satisfied the duties the bank owed.[96] The SEC provided limited further guidance in 1980 in a Securities Act Release for Rule 14e-3,[97] which has been narrowly read to suggest that, without the informed consent of clients, information barriers have limited effect as a defense to fiduciary liability.[98] Remarkably, the SEC has given no further guidance on the legal effect of information barriers to help firms resolve the fiduciary challenges of financial conglomeration.

It was only in 2011, long after financial conglomerates had expanded, that a court—in *Board of Trustees of AFTRA Retirement Fund v. JP Morgan Chase Bank*[99]—affirmed the legal efficacy of information barriers in satisfying fiduciary duties.[100] On behalf of its asset management clients, JP Morgan invested in securities of Sigma Finance, Inc. (Sigma). Simultaneously, the bank's investment-banking arm lent funds to Sigma, giving the bank a higher priority claim to Sigma's assets than that of its asset management clients. JP Morgan made the loan based on its investment banking arm's view that Sigma would collapse but that the collateral for the bank's loan would remain valuable. When Sigma did collapse during the Financial Crisis of 2007-09, the asset management clients lost their investments, while JP Morgan eventually profited—allegedly in the amount of almost $2 billion—by selling the assets collateralizing its loan to Sigma. The asset management clients claimed that JP Morgan had violated its duty of disclosure as well as its fiduciary duty to avoid conflicts of interest.

In a motion for partial summary judgment, the District Court dismissed both claims, placing importance on the curative effect of JP Morgan's information barriers. The information barrier ensured that individuals on either side of it—those investing for asset management clients on one side and those lending for the investment banking side on the other—made "independent decisions and shared no non-public information about Sigma."[101] In addition to preventing the spread of non-public information, the information barrier prevented the financial conglomerate's own commercial relationships from "influencing the advice and decisions made by the fiduciary in its fiduciary

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[96] Slade v. Shearson, Hammill & Co., Inc., 517 F.2d 398, 403 (2d Cir. 1974). *See also* Brief of the SEC, Amicus Curiae, Oct. 30, 1974, at 10–11. Restricted lists are lists kept by financial conglomerates identifying the securities in which they will not invest on their own account or on which they will not advise.

[97] Tender Offer Fraud Rule, Securities Act Release No. 6239, Exchange Act Release No. 17120 (Sept. 4, 1980) ("Depending on the circumstances, it may be appropriate to advise customers of its use of the Chinese Wall, because the institution would not be using all information that it had received to the benefit of a particular customer.").

[98] *See, e.g.*, Poser, *supra* note 20, at 110–11.

[99] 806 F. Supp. 2d 662 (S.D.N.Y. 2011).

[100] Before this decision, the most authoritative statement of the legal effect of information barriers was provided by the district court in Slade v. Shearson, Hammill & Co., Inc., 18 Fed.R.Serv.2d 265 (S.D.N.Y. Jan. 2, 1974). *See* Poser, *supra* note 20, at 108.

[101] Bd. of Trustees, 806 F. Supp. 2d 662, 688–89 & n.149 (S.D.N.Y. 2011) (citation omitted) (internal quotation marks omitted). The court noted that some individuals at JP Morgan—whom it referred to as "wall straddlers"—possessed information from both sides of the information barrier. *Id.* at 689. These individuals' presence did not compromise the information barriers' legal effectiveness.

capacity."[102] Treating the information barrier as conceptually carving the financial conglomerate into multiple distinct firms, the court reasoned that the firm violated no duty to avoid conflicts of interest—because it faced no conflict of interest.[103]

The court also rejected the claim that JP Morgan, in failing to disclose its own internal prediction that Sigma would fail, had violated its duty of disclosure to its asset management clients.[104] The court indicated that JP Morgan may have violated its duty of disclosure regarding its internal prediction about Sigma if the bank's asset management employees knew about that prediction.[105] Although the court left this issue for trial, its approach suggests that no duty to disclose information arose with regard to information in other parts of the firm—thereby confirming the view that information barriers (if effective in preventing information flows) will be seen as conceptually disaggregating the firm, permitting firms to discharge fiduciary obligations they would otherwise breach. The case settled before further proceedings were held, leaving the court's decision as the first—and only—decision squarely examining the effect of information barriers in satisfying fiduciary duties, but one that came long after the growth of financial conglomerates. The court's treatment of information barriers offers hope to financial conglomerates and yet its conclusions were conditioned on barriers' practical effectiveness in stanching information flows, which cannot be assured. It is uncertain whether other courts will follow the decision.

In the UK, doubt would seem to remain about whether information barriers solve the fiduciary dilemma. In 1995, after *Kelly*, the Law Commission stated that information barriers meeting the regulatory requirements for such barriers would modify inconsistent common law and equitable obligations (effectively satisfying fiduciary duties), although they noted that the matter was not free from doubt.[106] The Law Commission indicated that legislative change to deal with this uncertainty was desirable, but the provision it drafted was never adopted. Since then UK courts have given (conditional) effect to information barriers in helping firms to satisfy their (non-fiduciary) duty of confidence but not squarely addressed their effect in discharging fiduciary duties.[107]

In sum, in the US recent authority suggests that the use of information barriers may prevent fiduciary breaches, but it is unclear how widely the decision will be followed

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[102] *Id.* at 689 (citation omitted) (internal quotation marks omitted).

[103] The court also explained that JP Morgan was not acting in a fiduciary capacity when it made its loan and thus no conflict of interest arose between the bank and its client. *See id.* at 683-88.

[104] The investment management clients also alleged that the firm violated its duty to disclose its conflicts of interest. *Id.* at 693. However, the court reasoned that JP Morgan owed no such duty because no conflict of interest arose. *Id.* at 694.

[105] The court explained that the use of an information barrier cannot circumvent a duty to disclose information by "those employees on whom [investors] reasonably rely for important information and guidance—especially when the evidence strongly suggests that those employees were actually *kept in the loop about and aware of* the risks materializing in one of their fiduciary clients' [sic] largest investments." *Id.* at 695–96 (citations omitted) (internal quotation marks omitted). By inference, JP Morgan's information barrier would have protected it from disclosing its prediction about Sigma if its personnel on the (lending) side of the information barrier (and not also those on the asset management side) knew about that prediction.

[106] 1995 Law Commission Report, *supra* note 69, at 57.

[107] The leading authority is Prince Jefri Bolkiah v. KPMG [1999] 1 All E.R. 517.

and, in any case, it came too late to directly explain the weakness of the duty of loyalty as financial conglomerates grew and diversified. In the UK, uncertainty would seem to remain as to the legal effect of information barriers in preventing fiduciary breaches.

(c) The Modification of Fiduciary Principles by Regulation

Regulatory rules apply to many, if not most, of the activities in which financial conglomerates engage. Such rules generally do not entirely preempt the substantive law principles, but instead often co-exist with them.[108] Where the obligations imposed by fiduciary law and by regulation are inconsistent, or "mismatched," do fiduciary duties adapt to take account of the content of regulatory rules? If fiduciary duties adapt, conforming to the content of regulatory rules, fiduciary law might not pose onerous challenges for financial conglomerates. This would be the case if financial conglomerates can comply with regulatory rules, or at least avoid violating them, in situations that would otherwise breach fiduciary duties.

Common law actions did survive the passage of federal securities law in the 1930s, with the result that conduct not actionable under regulatory rules can still violate fiduciary duties under state common law. In *Gochnauer v. A.G. Edwards & Sons, Inc.*,[109] the court rejected the contention that statutory anti-fraud provisions and breach of fiduciary duty are co-extensive, asserting instead that, in the absence of clear legislative intent, courts should be reluctant to "foreclose[e] common law breach of fiduciary duty actions which supplement existing federal or state statutes."[110]

In the US, the District Court for the Southern District of New York in *Board of Trustees of AFTRA Retirement Fund v. JP Morgan Chase Bank*[111] took a different approach by recasting fiduciary principles based on the content of an overlapping and distinct regulatory regime. It cited the Gramm–Leach–Bliley Act of 1999 (GLBA)[112] as evidence that Congress endorsed the creation of certain multi-function financial institutions. This legislation had permitted commercial banks (or, more specifically, bank holding companies that qualified as financial holding companies) to engage not only in commercial banking, but also in investment banking, asset management, and insurance activities, among others. Its purpose was "[t]o reduce and, to the maximum extent practicable, to eliminate the legal barriers preventing affiliation among depository institutions, securities firms, insurance companies, and other financial service providers."[113] Taking a strict approach toward fiduciary duties would lead to extreme consequences, including "(1) a substantial increase in the cost of virtually all financial services transactions, (2) severe restrictions on the availability of [financial] products

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108 *See, e.g.*, Law Commission, *supra* note 5, at 26–49.

109 810 F.2d 1042 (11th Cir. 1987).

110 *Id.* at 1048 (citing Santa Fe v. Green, 430 U.S. 462 (1997)). *See also* EBC I, Inc., v. Goldman Sachs Co., 91 A.D.3d 211, 221 (2011) (rejecting a financial conglomerate's argument that a claim that it had breached the fiduciary duty it owed in advising its (underwriting) client was preempted by federal securities law).

111 806 F. Supp. 2d 662 (S.D.N.Y. 2011).

112 Financial Services Modernization Act (Gramm–Leach–Bliley Act), Pub. L. No. 106-02, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

113 H.R. Rep. No. 106-74, pt. 1, at 2 (1999).

and services ... and, ultimately, (3) the disaggregation of commercial and investment banking functions from asset management ... ."[114] Although the GLBA did not address the resolution of incompatible duties, its express approval of financial conglomeration led the court to reject arguments that the firm had violated its fiduciary duties when it acted as an agent for certain clients while simultaneously taking action (as a lender) inconsistent with those clients' interests. If financial conglomerates were to be held to their fiduciary duties—here, effectively preventing a firm from becoming a secured lender of an issuer whose securities it held as a fiduciary—"surely [that conclusion] would be reflected in the extensive regulations that govern the banking industry."[115]

Of course, by the time of this decision commercial banks had already grown and diversified and were performing multiple functions on a massive scale. The decision therefore does not directly account for their growth. It also does not directly explain the growth of investment banks which, although structured as financial conglomerates and thus subject to conflicts as described above, did not benefit from legislation like the GLBA that could be regarded as changing the content of fiduciary law. It is also unclear how broadly the decision would be applied to other fact patterns; a court grappling with the possibility that a bank owed incompatible duties in the context of structured finance transactions observed that "it is no answer to say that the bank owed a conflicting duty to another. That makes matters worse, not better."[116] Nevertheless, financial conglomerates may have expected that courts would not enforce fiduciary duties where doing so would undermine regulation that permitted firms to grow and diversify their operations.

In the UK, the Law Commission in its 1992 consultation paper tentatively suggested, without referring to any directly relevant authority, that courts would modify the content of fiduciary duties when they were inconsistent with regulatory rules. In 2014, the Law Commission, focused on legal developments since 1992, expressed greater confidence that courts would take this approach.[117] It contended that courts would interpret fiduciary duties as "subject to" regulatory rules, suggesting that they would conform to such rules in the same manner they conform to contractual provisions in the UK.[118] In their view, courts would be "heavily influenced" by the content of regulatory rules in interpreting fiduciary duties, and would be reluctant to impose fiduciary liability on market participants for the benefit of a sophisticated client if the actor had complied with its regulatory requirements.[119] The case law on the issue is surprisingly sparse.[120]

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114 *Id.* at 690.

115 *Id.*

116 In re Parmalat Sec. Litig., 684 F.Supp.2d 453, 478 (S.D.N.Y. 2010).

117 LAW COMMISSION, FIDUCIARY DUTIES AND INVESTMENT INTERMEDIARIES, 2014, [10.08] (U.K.).

118 *Id.*

119 *Id.* at [10.42].

120 Although the Commission expressed its view with confidence, greater authority would seem to support the claim that common law (non-fiduciary) *duties of care* conform to equivalent regulatory rules. *Id.* at [10.59]–[10.66].

(d) Mandatory Arbitration of Client Disputes

A related explanation for the continued growth and diversification of firms in the US despite the imposition of fiduciary constraints concerns the use of arbitration in the securities industry. In the late 1980s, the US Supreme Court upheld the enforceability of contractual provisions which require clients to relinquish their rights to litigate disputes with broker-dealers and instead resolve them by arbitration.[121] Afterward, virtually all financial conglomerates adopted these so-called mandatory arbitration provisions in contracts with broker-dealer clients, including retail clients;[122] investment advisers also commonly use such provisions.[123] These provisions typically "cover[] all disputes arising under federal law, state law, and [Self-Regulatory Organization] rules."[124] In consequence, disputes that would otherwise have been litigated were resolved by arbitration. So comprehensive was the arbitration regime that reported cases concerning the duties of financial conglomerates toward their broker-dealer clients—the context in which the fiduciary dilemmas occurred most frequently—virtually "vanished" in the early 1990s.[125] There were thus few opportunities for courts to resolve disputes between financial conglomerates and their clients in the broker-dealer context, where conflicts often arose.[126] The SEC could still bring enforcement actions, for example, although it did not pursue claims that forced firms to confront the challenges that fiduciary doctrine posed for their business model. For their part, arbitrators rarely provided written reasons for their awards,[127] preventing parties or others from knowing the legal principles on which they had relied in making decisions and preventing the development of those principles. Arbitrators were also regarded as favoring firms over their customers.[128] Nevertheless, breach of fiduciary duty was, and remains, among the claims most commonly advanced by clients in arbitration.[129] Thus,

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[121] *See* Rodriquez de Quijas v. Shearson/ Am. Express, Inc., 490 U.S. 477, 482-84 (1989); Shearson/ Am. Express, Inc., v. McMahon, 482 U.S. 220, 234–40 (1987).

[122] *See* Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 124 (2005) ("[V]irtually all investor claims against brokers are now subject to mandatory arbitration.").

[123] *See, e.g.*, Massachusetts Securities Division, *Report on Massachusetts Investment Advisers' Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts*, 2 (Feb. 11, 2013), available at http://www.sec.state.ma.us/sct/sctarbitration/Report%20on%20MA%20IAs'%20Use%20of%20MPDACs.pdf, last accessed August 3. 2017.

[124] *See* SEC. & EXCH. COMM'N, *supra* note 14, at 80 n. 378.

[125] *See* Frederick Mark Gedicks, *Suitability Claims and Purchases of Unrecommended Securities: An Agency Theory of Broker-Dealer Liability*, 37 ARIZ. ST. L.J. 535, 564 (2005). *See also* Roberta S. Karmel, *Is the Shingle Theory Dead?*, 52 WASH. & LEE L. REV. 1271, 1294 (1995) ("As a result of [the use of mandatory arbitration clauses], customers have brought relatively few court cases against broker-dealers since 1987.").

[126] *See* Barbara Black & Jill I. Gross, *Making it up as they go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1014–30 (2002).

[127] *See id.* at 1030; Johnson, *supra* note 122, at 143–44.

[128] *See* Black & Gross, *supra* note 126, at 1047.

[129] *See id.* at 993. For current data, see http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics#top15controversycustomers, last accessed August 3. 2017 (showing that breach of fiduciary duty was the most common "controversy type" in arbitration cases filed

shortly after the fiduciary dilemmas were broadly recognized for financial conglomerates, opportunities for disputes to be publicly ventilated and ruled on by courts significantly diminished in the US, suggesting that weaknesses in the force of fiduciary doctrine stemmed in part from the inability of parties to litigate their concerns.

(e) Non-Enforcement of Fiduciary Duties

Another potential explanation relevant in particular contexts outside the scope of arbitration agreements is that clients themselves are reluctant to challenge financial conglomerates for breach of fiduciary duty. Fiduciary law relies for its force on private enforcement; its duties are not self-executing. Relevant contexts include where financial conglomerates perform the investment banking functions of advising on M&A and underwriting securities offerings, activities in which arbitration provisions tend not to be used, perhaps because firms consider them unnecessary.

Clients may not enforce fiduciary law for any of several reasons. First, some conflicts are hard for outsiders to detect, especially for those clients with little experience of the financial services industry. Conflicts will often arise through the trading or investing activities of financial conglomerates, but clients will have difficulty observing these activities and, even if they can, determining whether observed trading was undertaken on the conglomerate's own account (as principal) or simply on behalf of and under the direction of another client. Second, for some clients, the expected cost of litigating a matter (potentially including the loss of relationship with a major firm) may more than offset the expected remedy, or at least weigh heavily against their litigating the matter.

Finally, if the wronged client is a corporation, those acting on its behalf—often its directors—may fail to act consistently with the client's interests. Although this reason is somewhat speculative, it finds support in some settings. In the M&A context, for example, directors rarely enforce fiduciary duties against their advisers, despite legal doctrine suggesting the fiduciary character of the M&A adviser's role.[130] Directors' lax approach may be explained by the natural divergence of interests between senior managers and shareholders, a divergence that is likely more pronounced in the M&A context than in others, because these deals threaten senior managers with removal from office.[131] Directors may avoid holding their advisers to account because doing so would reflect poorly on their own performance by suggesting that they, the directors, had failed to reasonably oversee their advisers.[132] This divergence between directors'

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with FINRA from 2013 to 2016; other controversy types included negligence, failure to supervise, misrepresentation, and suitability).

[130] The cases are rare, and many were brought by Chapter 11 trustees in bankruptcy or bankruptcy debtors-in-possession. *See* Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079, 1119–21 (2016).

[131] *See, e.g.*, In re El Paso Corp. S'holder Litig., 41 A.3d 432, 439 (Del. Ch. 2012) ("[T]he potential sale of a corporation has enormous implications for corporate managers and advisors, and a range of human motivations, including but by no means limited to greed, can inspire fiduciaries and their advisors to be less than faithful …").

[132] When directors are misled by the self-interested conduct of their M&A advisers, directors may be found to have breached their own fiduciary duties to the corporations they manage. For

interests and those of their shareholders is one that financial conglomerates have exacerbated, including by offering stock in "hot" IPOs to managers in their personal capacities (a practice described as "a flagrant attempt to ingratiate themselves to [managers]"[133]) and by giving them personal loans.[134] There may, of course, be other explanations; some may even suggest that financial conglomerates, though more conflicted than they were in the past, successfully "managed" their conflicts by not exploiting them, thus imposing no harm and giving clients no justification for complaining. Understanding this client tendency will require further inquiry.

CONCLUSION

In the UK, the willingness of courts to conform fiduciary duties to contractual terms and to otherwise inconsistent regulatory rules goes a long way toward explaining the weak practical effect of fiduciary law as financial conglomerates grew and diversified. In the case of the US, I tentatively conclude that the weak deterrent force of fiduciary duties owes less to changes in the law than to inhibitions on its enforcement. Fiduciary duties have retained their vigor in important contexts. Information barriers are widely used, but they were not endorsed by a court as a measure for preventing fiduciary liability until 2011, long after significant firm growth and diversification had occurred. The same case illustrates judicial willingness to mold fiduciary duties to otherwise inconsistent regulatory provisions, but it remains to be seen whether courts will follow it. The growth of financial conglomerates in the US occurred against the backdrop of remarkably little judicial scrutiny—perhaps the result of the mandatory use of arbitration to resolve broker disputes and the reluctance of parties to enforce fiduciary duties.

Although the threat posed to firms' organizational structure and practices by fiduciary law has diminished in the US, financial conglomerates face ad hoc challenges from fiduciary law. Financial conglomerates face fiduciary status under new Department of Labor rules when they provide "investment advice or recommendations" to IRA owners or retirement plan beneficiaries.[135] They even face the possibility of greater litigation of broker disputes given the power of the SEC under

a discussion of other factors explaining the failure of corporate clients to hold their financial conglomerate advisers to account, see Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079, 1120–23 (2016).

[133] CHARLES R. GEISST, WALL STREET: A HISTORY 388 (1997). *See also* Therese H. Maynard, *Spinning in a Hot IPO—Breach of Fiduciary Duty or Business as Usual?*, 43 WM. & MARY L. REV. 2023, 2023–8 (2002).

[134] *See, e.g.*, Liz Hoffman, *Valeant CEO Forced to Sell Company Stock in Margin Call*, WALL STREET J. (Nov. 6, 2015, 7:02 PM), http://www.wsj.com/articles/goldman-sells-valeant-shares-used-as-collateral-by-ceo-1446815823, last accessed August 3. 2017 (describing loans totaling $100 million by an investment bank to a company's chief executive officer where the bank had recently earned an estimated $85 million in fees from that company).

[135] "Definition of the Term 'Fiduciary'; Conflict of Interest Rule – Retirement Investment Advice" (81 Fed. Reg. at 20946, 20946 [Apr. 8, 2016] to be codified at 29 C.F.R. pts. 2509-2510, and 2550).

recent reforms to consider whether to prohibit or otherwise limit the use of mandatory arbitration provisions in the securities industry.[136] For their part, financial conglomerates can be expected to oppose the imposition of fiduciary duties, as they have in the past.[137] They can also be expected to continue to rely for support on the securities trade association, now known as the Securities Industry and Financial Markets Association,[138] which has warned of the dangers that fiduciary law poses for the continued operation of financial conglomerates[139] and supported the use of pre-dispute mandatory arbitration provisions.[140]

I have explored the puzzle of how financial firms have managed to continue growing and diversifying despite the imposition of fiduciary duties generally seen as robust. I have contrasted the development of fiduciary law in the US and UK and illuminated how the deterrent force of fiduciary law in shaping conduct depends not only on the formulation of legal doctrine, on which fiduciary scholarship has traditionally focused, but also on the willingness and ability of parties to challenge violations of this doctrine. Future scholarship might usefully explore why and under what conditions the beneficiaries of fiduciary duties assert their rights. Doing so would contribute to our understanding of why fiduciary doctrine may have diminished in force and of what might be done if we conclude that change should occur.

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136 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010), Section 921.

137 As to financial conglomerates' resistance to fiduciary constraints, *see*, *e.g.*, Goldman Sachs in its Business Standards Committee Impact Report, acknowledging that it owes fiduciary duties only when acting as an investment manager, rather than in the various other roles it performs. GOLDMAN SACHS, BUSINESS STANDARDS COMMITTEE IMPACT REPORT MAY 2013, at 8 (2013), ("Goldman Sachs acts in many different roles across our various businesses, including as advisor, fiduciary, market maker and underwriter … . [O]ur responsibilities as a market maker are quite different from our responsibilities as an investment banking advisor or our fiduciary responsibilities when acting as an investment manager."). The firm has publicly opposed claims that it owes fiduciary duties in its M&A and underwriting activities. *See*, *e.g.*, EBC I, Inc. v. Goldman Sachs & Co., 91 A.D.3d 211, 218 (N.Y. App. Div. Dec. 8, 2011); Mannesmann AG v. Goldman Sachs Int'l, [1999] EWHC (Ch) 837, [3], [8]. As to the firm opposing the fiduciary constraints on its market-making activities, *see generally*, *Wall Street and the Financial Crisis: The Role of Investment Banks: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs*, 111th Cong. 7, 26–7 (2010).

138 This was formerly the Securities Industry Association.

139 *See*, *e.g.*, Memorandum of Law of Amicus Curiae The Securities Industry and Financial Markets Association in Support of the Motion for Partial Summary Judgment by JP Morgan Chase Bank, NA, Board of Trustees of AFTRA v. JP Morgan Chase Bank (US Dist. Ct, SDNY, No. 09-cv-00686), Mar. 3, 2011; Brief Amicus Curiae of the Securities Industries Association in Support of Defendant-Appellant Goldman, Sachs & Co., EBC I, Inc v. Goldman Sachs & Co. (Ct. App. NY), Dec. 23, 2004.

140 *See* SIFMA, WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY 48 (Oct. 2007) ("Given the fairness, speed and cost-effectiveness of arbitration, there is no sound public policy reason to preclude securities firms from providing for arbitration in customer agreements.").