LARRY RIBSTEIN'S FIDUCIARY DUTIES

Kelli A. Alces∗

Larry Ribstein, throughout his remarkable scholarly career, developed a theory formed around his analysis that the end of fiduciary obligation is a near possibility. Understanding fiduciary obligations as a carefully defined term may indicate, however, that this fiduciary obligation can be a useful part of a wider selection of relationships than Ribstein allowed. This Article both considers Ribstein's theory of fiduciary duty, and ultimately turns that same theory on its head by advocating the use of a narrow duty in a variety of contexts as opposed to a broad duty in a limited range of circumstances.

TABLE OF CONTENTS

I. INTRODUCTION

Over the course of his remarkable scholarly career, Larry Ribstein carefully developed a theory of fiduciary duties that explains the ad-

∗ Loula Fuller and Dan Myers Professor of Law, Florida State University College of Law. This essay is dedicated to the memory of my corporate law teacher, mentor, and friend Larry Ribstein. He left us far too soon and is dearly missed. We are very fortunate to have the rich body of scholarship he left behind to guide us as we continue to try to find answers to important legal questions. Though Larry taught me most of what I know about fiduciary duties, he would want me to point out that all errors in the analysis here are my own.

vantages of his favored uncorporations, the essence of a contractarian view of corporate governance, and the role of trust in legal relationships.[1]

Conventional wisdom has held that fiduciary relationships are widespread and best understood as broad commands against selfish behavior that lead to obligations to act with the utmost good faith and loyalty. To the contrary, Ribstein argued that fiduciary duties are optional contract terms that parties can choose to have in relationships where one party exercises discretion and control over the assets of the other.[2]

Ribstein was not opposed to fiduciary obligation, nor did he think it should be removed from corporate law. Rather, he argued that the fiduciary duty of loyalty, properly understood, was essential to managing the agency costs occasioned by the complete delegation of control over corporate assets to a board of directors.[3] He believed that parties agreed by contract to enter into relationships that implicate fiduciary obligation, and so they should be able to modify those duties or opt out of them all together, in designing the legal relationship desired by the parties.

The rise of uncorporations[4] as popular alternatives to the corporate form is due, in part, to this narrow understanding of fiduciary duties. Uncorporations allow owner-members and managers to opt out of fiduciary duties in many instances and to define the terms and limits of the fiduciary obligations they may impose on one another.[5] Ribstein was among the first to challenge the conventional wisdom that partners and agents are always fiduciaries.[6] Though he advocated a limited role for fiduciary duties, he maintained that fiduciary obligation could be useful in some instances, but that it could be harmful if invoked too often or in too many circumstances.[7]

It may be possible to see the end of fiduciary obligation from Ribstein's analysis. If the duty of loyalty is only appropriate in limited circumstances and then is only enforced as a narrow obligation to refrain from self-dealing, then it may evolve to be a narrow, specific contract term.

1. *See, e.g.*, LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 1–2 (2010); Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 212–14 [hereinafter Ribstein, *Are Partners Fiduciaries*]; Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 900 (2011) [hereinafter Ribstein, *Fencing*]; Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 540 (1997) [hereinafter Ribstein, *Fiduciary Contracts*]; Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 555–56 (2001) [hereinafter Ribstein, *Law v. Trust*].

2. Ribstein, *Are Partners Fiduciaries*, *supra* note 1, at 212.

3. Ribstein, *Fencing*, *supra* note 1, at 919.

4. The "uncorporation" is a term Ribstein coined to describe unincorporated business associations. RIBSTEIN, *supra* note 1, at 1 ("The term presently includes general and limited partnerships, limited liability companies (LLCs), and variations on these entities."). His seminal work on this topic, the culmination of his life's work in studying business associations, is his book THE RISE OF THE UNCORPORATION, published in 2010.

5. *Id.* at 171–79.

6. Ribstein, *Are Partners Fiduciaries*, *supra* note 1, at 251 ("[P]artners or equivalent parties have [fiduciary] duties only as agents or as managers of centrally managed firms.").

7. Ribstein, *Law v. Trust*, *supra* note 1, at 555–56 (arguing that mandatory regulation could decrease trust by giving parties a weapon they could use opportunistically).

Alternatively, understanding fiduciary obligation as a carefully defined term may reveal that fiduciary duty can be a useful part of a wider variety of relationships than Ribstein would have allowed. We may find a broader application for a specific and well-understood obligation. This Article will consider the implications of Ribstein's theory of fiduciary duty both within and beyond business association law and turn Ribstein's theory on its head, ultimately advocating the use of a narrow duty in a variety of contexts rather than a broad duty in limited circumstances.

Part II explains Ribstein's theory of fiduciary duty and situates it in the legal academic debate on the subject. Ribstein's narrow view of fiduciary duties contrasts starkly with other perspectives advocating the use of fiduciary duties in a variety of fields to inspire trust and confidence among strangers. His theory convincingly explains the very limited use of fiduciary liability in business association law. Part III explores the application of fiduciary duty to business associations, both corporate and uncorporate forms alike. It finds that the duty of loyalty that managers owe firms in business association law is not strictly enforced when mandatory, and is becoming increasingly optional in unincorporated firms. Part IV combines the best of both approaches to find a more consistent, accurately descriptive theory of fiduciary duty. It argues that a relatively clear understanding of the duty of loyalty can be consistently and predictably applied in a variety of relationships and need not be the path to unrestrained liability that Ribstein feared.

II. FIDUCIARY DUTY, DEFINED

Ribstein subscribed to the school of thought holding there is only one fiduciary duty: the duty of loyalty.[8] The duty of unselfishness is the only true fiduciary duty because it is the only duty unique to fiduciary relationships. Indeed, in Ribstein's view, one party's agreement to "renounce" all thought of self defines the relationship as fiduciary.[9] Completely selfless behavior is rarely justified and difficult to enforce.[10] Thus, Ribstein argues that we should use fiduciary relationships only rarely and only in particularly defined situations.[11] Because the enforcement of the

8. Noting other scholars with whom he agreed on this point, Ribstein cited Matthew Conaglen, *The Nature and Function of Fiduciary Loyalty*, 121 L.Q. Rev. 452, 459–60 (2005); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1048 (1991); L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 74–79 (discussing categories of fiduciary duties but indicating that each incorporated an obligation of loyalty); J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 LAW Q. REV. 51, 75 (1981) (defining a fiduciary relationship as a "duty to utilise that power in the best interests of another"); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1406 (2002) (defining fiduciary duty as a duty of loyalty or unselfishness). Ribstein, *Fencing*, *supra* note 1, at 901 n.7.

9. *Id.* at 903 (adopting Judge Cardozo's famous language in *Meinhard v. Salmon* describing fiduciary obligation in strong terms requiring completely selfless conduct).

10. *Id.* (noting that selfless behavior "undermines the incentives that motivate business people to provide high-quality goods and services").

11. *See id.*

fiduciary duty requires *ex post* review of the fiduciary's behavior by a court, it is important that the fiduciary duty of loyalty be defined in the stark terms of complete selflessness because then it can be predictably enforced.[12] According to Ribstein, selfishness is easier to identify and correct than simple negligence or harm to the beneficiary, so the court will be able to identify and correct the fiduciary's lapse in loyalty.[13]

Of course, fiduciaries owe other duties to their beneficiaries, but those duties are not fiduciary in nature because they are also owed by nonfiduciaries; even within fiduciary relationships, they are not central to the fiduciary nature of the relationship. For example, the duty of care is not a fiduciary duty in Ribstein's view because it would be impossible, impractical, and probably undesirable for a fiduciary to be unselfish "regarding the fiduciary's commitment of time and attention."[14] Further, one who agrees to perform a task on behalf of someone else must also agree to perform that task with care.[15] An obligation to exercise care is not the same as undertaking a fiduciary obligation. Because one does not give rise to the other, and because a party may owe a duty of care without having a fiduciary relationship, Ribstein reasons that the duty of care is not a fiduciary duty even though it is a duty to which all fiduciaries are bound.[16]

Because the fiduciary duty of loyalty requires strict unselfishness, which is a lot to ask of a legal relationship between strangers, it is only appropriate or desirable in certain limited circumstances. Ribstein argues that fiduciary duties are only justified in relationships involving "a property owner's delegation to a manager of open-ended management power over property without corresponding economic rights."[17] That is, where there is a separation of ownership from control, fiduciary duties are necessary to prevent the fiduciary from using the property entrusted to it for personal benefit.[18] This limited universe of relationships that Ribstein views as appropriately fiduciary includes those between corporate directors and the corporation and between trustees and the beneficiaries of a trust. It excludes, however, other relationships that have been traditionally categorized as fiduciary, such as agency relationships, partnerships, attorney/client relationships and doctor/patient relationships.

In this way, Ribstein's view contrasts importantly with other dominant theories of fiduciary obligation. For instance, Frank Easterbrook and Dan Fischel have argued that fiduciary duties are justified whenever the gaps in a given contract are sufficiently large and monitoring is sufficiently difficult that parties want courts to use principles of fiduciary ob-

12. *See id.*
13. *Id.* at 904.
14. Ribstein, *Are Partners Fiduciaries*, *supra* note 1, at 220.
15. *Id.* at 220–21.
16. *Id.* (explaining that a doctor can owe a patient a duty of care without being a fiduciary).
17. Ribstein, *Fencing*, *supra* note 1, at 901.
18. *Id.*

ligation to fill those gaps when considering what terms the parties would have agreed to had they negotiated about the circumstance at issue *ex ante*.[19] Tamar Frankel has argued that fiduciary duties are justified in relationships of trust where one party is vulnerable to the other's judgment or expertise.[20] These conceptions of fiduciary relationships allow that fiduciary obligation may be appropriate to protect vulnerable parties in a wide variety of relationships.

Under the Easterbrook-Fischel approach, contractual relationships fall along a continuum between those that are not fiduciary in nature at all and those that are completely fiduciary.[21] Where a particular relationship falls depends on how large the gaps in the contract are, how much about the parties' behavior is left undetermined by the contractual terms, and how difficult it is for one party to monitor the other.[22] Then, when faced with a potential breach of duty, courts apply the standard of fiduciary obligation to reach a result that approximates what the parties would have agreed to had they negotiated about a particular circumstance at the outset. That is, the court assumes the parties would have agreed upon a result in which the fiduciary behaved unselfishly in pursuing the best interests of the beneficiary. Using this reasoning, parties could contract for a fiduciary relationship whenever they agree that one party should selflessly pursue the interests of the other. They would be free to reach this agreement whether or not there is a broad delegation of control over the beneficiary's property.

Ribstein responded to this approach in part by arguing that other methods of constraining agency costs work much better in most of those situations and if other mechanisms are more cost effective, they should be preferred to fiduciary obligation.[23] Ribstein's argument in favor of limiting fiduciary obligation to only the one kind of relationship is significantly predicated on the idea that fiduciary obligation should be the last resort.[24] It is difficult, though, to be confident that nonfiduciary mechanisms will always work so well, or that fiduciary obligation will not be more effective if both parties agree to its application, particularly if they both know what it means and what the consequences of breach are. If fiduciary obligation is supposed to be a freely imposed creature of contract, why could parties not decide it is the cheapest or easiest way to allocate rights and responsibilities between them? Where they have made

19. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) ("The duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced.").

20. Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 809–10 (1983).

21. Easterbrook & Fischel, *supra* note 19, at 438.

22. *Id.* ("When transaction costs reach a particularly high level, some persons start calling some contractual relations 'fiduciary' . . . .").

23. Ribstein, *Are Partners Fiduciaries*, *supra* note 1, at 233.

24. *See id.* at 232–37 (arguing that fiduciary duties may weaken alternative constraints by undermining voluntary cooperation or deterring nonmanaging owners from exercising governance rights).

that choice, does that not indicate that the parties have decided that it is the best course of action or contract term for them?

Indeed, some scholars note the usefulness of fiduciary obligation in instances where one party is necessarily vulnerable to the other's judgment or performance of a task.[25] In these situations, which likely fall at the fiduciary end of Easterbrook and Fischel's continuum, the parties might feel that selflessness is necessary and that the vulnerable party's inability to monitor makes other forms of constraining agency costs impractical. This "entrustment" theory of fiduciary obligation, most notably developed by Tamar Frankel,[26] aims to encourage parties to engage in transactions from which they might otherwise abstain because the transaction or relationship makes them too vulnerable to the counterparty's ability to take advantage. For instance, a patient may not be willing to entrust her health to a surgeon's skill without some assurance that the doctor is bound to eschew self-interest and work solely for the patient's benefit in performing the surgery.[27] Fiduciary duties, Frankel argues, exist to encourage the trust that is necessary to enter into a variety of relationships and transactions. It is hard not to leave with the impression that this view sees fiduciary obligation as a command to the fiduciary to "be nice" or "be honest and loyal" in a more common, social sense. Some call this social aspect of loyalty "being true."[28] Fiduciary obligation exists to give entrustors peace of mind that their fiduciaries have their best interests *at heart*.

Ribstein argued, to the contrary, that trust and kindness are extralegal. That is, if you have to legally enforce an obligation to be trustworthy, you do not trust. If you have to legally enforce kindness, it is not kindness. Regulation and legal rules undermine rather than promote trust, because trust is defined by faith in the face of vulnerability.[29] And legal rules cannot give you faith you do not have. They only provide protection from some of the costs of disappointment. When the law intervenes to protect a vulnerable party from another's abuse of power, the vulnerable party is not trusting.[30] The vulnerable party does not have to trust because the law protects that party.[31] Ribstein argued that parties would not enter into relationships that presented too great a risk of vulnerability without legal protection. They therefore were not trusting.

25. Frankel, *supra* note 20, at 816 ("Because the entrustor cannot satisfactorily protect himself while maintaining the benefits of the fiduciary relation, the law must intervene to protect him from abuse of power by rules that are sensitive to the dangers that the relations pose for the entrustor.").

26. Tamar Frankel, *Fiduciary Law in the Twenty-First Century*, 91 B.U. L. REV. 1289, 1291–92 (2011) [hereinafter Frankel, *Twenty-First Century*]. Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1215–19 (1995) [hereinafter Frankel, *Default Rules*]; Frankel, *supra* note 20, at 832–36.

27. *See* Frankel, *Twenty-First Century*, *supra* note 26, at 1293.

28. *See* Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 489 (2009) (internal quotation marks omitted).

29. Ribstein, *Law v. Trust*, *supra* note 1, at 555–56 (explaining that regulations can cause distrust because parties can use them opportunistically).

30. *Id.* at 558–59, 571.

31. *Id.* at 571.

Trust, Ribstein maintained, is for personal relationships and the "law *substitutes for* rather than *complements* trust."[32]

Ribstein's view of trust and fiduciary obligation differed widely from his peers. While other scholars saw fiduciary obligation as a way to promote trust and allow for greater protection in relationships defined by vulnerability,[33] Ribstein counted on parties to protect themselves *ex ante* and only to rely on the *ex post* judicial review occasioned by fiduciary law when nothing else would suffice.[34]

There is, however, a middle ground. Ribstein argued that the duty of loyalty, when properly employed, would mean complete selflessness in limited circumstances. When we look, in Part III at how fiduciary duties are enforced in the limited circumstances Ribstein identified, we find a duty that requires much less than complete selflessness. On the other hand, many scholars argue that fiduciary duties should lead to complete selflessness by fiduciaries in a variety of situations. This Article advocates a view of fiduciary duty that adopts the narrow application we see in business associations and allows that narrowly defined duty to be used in a variety of situations marked by the relative vulnerability of one party. The problem Ribstein correctly identified with more expansive understandings of fiduciary obligation is that they can be indeterminate and costly to enforce. When we look at how most relationships that are considered "fiduciary" are actually managed, however, we see that the obligations of the fiduciaries are actually quite carefully defined. We may acknowledge that fiduciary duties are supposed to be applied flexibly *ex post* to determine if unanticipated behavior violates the duty, but we also find great utility in defining as many of the terms of the relationship as possible *ex ante*.

Taken to its logical conclusion, Ribstein's narrow view of fiduciary obligation could spell the end of fiduciary relationships entirely as there are almost always other mechanisms available for closing gaps. That realization, combined with the high costs of enforcing fiduciary duties against corporate managers, has led to a decline in the strength and significance of fiduciary duties in business association law. Ribstein, in particular, tracked this decline through the rise of LLCs that do not require fiduciary duties to obligate managers to the firm's owners. Part III of this Article considers the decline of fiduciary duties in business associations. Then, Part IV suggests some ideas about what that decline might mean for future work on the theory supporting the use of fiduciary rela-

32. *Id.* at 556.

33. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 902; Frankel, *Default Rules*, *supra* note 26, at 1215–19.

34. Ribstein, *Are Partners Fiduciaries?*, *supra* note 1, at 213 ("Applying fiduciary duties broadly threatens to undermine parties' contracts by imposing obligations the parties do not want or expect."); Ribstein, *Fiduciary Contracts*, *supra* note 1, at 541 (characterizing fiduciary duties as a hypothetical bargain); *see also* Easterbrook & Fischel, *supra* note 19, at 427 (explaining that fiduciary duties replace contract terms that parties could not practically bargain over *ex ante*).

tionships generally, and how continuing to use fiduciary law could be most helpful.

III. Fiduciary Duties and Business Associations

Fiduciary obligation is one method of limiting the agency costs inherent in the separation of ownership from control in the modern corporation. The corporation presents one of the paradigmatic cases for fiduciary obligation under Ribstein's theory.[35]

There, owners (the shareholders) delegate authority over their property (corporate assets) to managers who are bound to act selflessly in managing that property for the benefit of the owners. Of course, much in corporate law scholarly literature has challenged various parts of this conventional agency understanding of the allocation of ownership and control in the corporation, but the traditional description of the relationships used by Ribstein's analysis suits our purposes. Under the agency view, corporate officers and directors must not engage in transactions in which their personal interests are in conflict with the profit-maximizing interests of the corporation. They must only pursue corporate interests in deciding how to operate the firm. If directors or officers violate this duty of loyalty, the corporation can sue them, or the shareholders can sue on the corporation's behalf. Here, it is the delegation of open-ended control over assets belonging to another that justifies the use of the duty of loyalty to prevent managers from distributing the property under their control to themselves.[36]

A. Corporations

Ribstein argued that corporations are one paradigmatic case for the application of fiduciary obligation. In corporations there is a "property owner's delegation to a manager of open-ended management power over property without corresponding economic rights."[37] The separation of ownership from control in corporate governance seems to lend itself to adoption of a duty of loyalty under Ribstein's theory.

1. The Duty of Loyalty

The duty of loyalty prohibits corporate officers and directors from engaging in transactions or pursuing courses of action in which their personal financial interest conflicts with that of the corporation. If a manager wants to pursue such a transaction, she must receive the approval of the disinterested members of the board, a majority of disinterested shareholders, or be able to demonstrate that the transaction in question

35. Ribstein, *Fencing*, *supra* note 1, at 901.
36. *Id.* at 904.
37. *Id.* at 901.

is inherently fair to the corporation.[38] This generally means that directors cannot deal with the corporation themselves without disclosing their role in the transaction to the rest of the board and receiving the requisite approval of the deal. It also means that directors may not, for instance, favor close relatives in granting contracts with the firm to others. The doctrine of corporate opportunity, which prevents a director or officer from taking a business opportunity in the corporation's line of business that the corporation has the ability to pursue, is another application of the duty of loyalty.[39] In taking the opportunity, the fiduciary would be taking for herself potential profit that she should be seeking for the corporation. In order to pursue the opportunity individually, the officer or director must obtain permission from the board.[40]

Within these standard examples of liability for breach of the duty of loyalty, the duty boils down to a narrow, straightforward contract term, simply, "[D]on't be . . . conflicted without permission."[41] We simply ask some parties not to pursue self-interest ahead of the interests of another while performing a particular task. No fiduciary is asked to eschew self-interest in all areas of life or even business, only in those that would directly conflict with the task for which he has agreed to act as fiduciary. Within that narrow scope exact conflicts may be hard to anticipate, but they are not hard to identify.

In recent years, the Delaware Supreme Court has used dicta in fiduciary duty cases to try to expand the common understanding of the scope and nature of the corporate duty of loyalty.[42] In *Stone v. Ritter*, the court explained that actions taken in bad faith, such as an intentional failure to perform a known duty, would constitute breaches of the duty of loyalty, even though the bad behavior described would traditionally be understood to fall within the duty of care.[43] Andrew Gold has expressed concern that this expansive rhetoric, if enforced, may allow directors to be held liable for breaching the duty of care even when they believe the action they are taking is in the best interests of the corporation.[44]

Fortunately, the Delaware Supreme Court took away with one hand what it gave with the other. Very shortly after *Stone v. Ritter*, the court made clear in *Lyondell Chemical Co. v. Ryan*[45] that liability for actions taken in bad faith would be rare, as bad faith is a difficult standard for plaintiffs to meet. This is not to say that the court's rhetoric has no force.

38. DEL. CODE ANN. tit. 8, § 144(a) (West 2010). The disinterested requirement has been read in by courts. *See, e.g.*, Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976).

39. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

40. *See id.* at 513 (holding an officer violated his duty of loyalty and finding he did not present an opportunity to his corporation's board before taking it for himself).

41. Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 269 (2009) [hereinafter Alces, *Debunking*] (defining a conflict of interest as a financial conflict, not an egregious failure of care, and pointing out that standards of care may not be fiduciary).

42. Gold, *supra* note 28, at 459 (citing Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006)).

43. *Id.* at 470–71.

44. *Id.* at 459, 470–74.

45. 970 A.2d 235, 243–44 (Del. 2009).

It influences the norms that apply to guide director behavior and shape shareholders' and directors' expectations about how directors ought to behave.[46] Still, without liability, or even a credible threat of liability, it is hard to say that these norms have become part of the enforceable duty.

Although the court's recharacterization of bad faith as a breach of the duty of loyalty may seem like a significant step in the direction of expanding the duty of loyalty, the change can be characterized as mostly rhetorical. Breaches of the duty to act in good faith have always been punishable with monetary liability,[47] so the remedy has not changed. In practice, the fact that the Delaware courts now call a failure to act in good faith a breach of the duty of loyalty makes no difference. While the bad faith standard is now better understood, it requires only a low standard of conduct and it is still only rarely enforced with liability.[48]

2. The Duty of Care

Unfortunately for litigious shareholders and their attorneys, the corporate duty of care is even more limited. A common understanding of "fiduciary" seems to imply that a fiduciary must exercise extreme care—perhaps as much care as he would exercise if he were performing the task for himself.[49] The business judgment rule, a presumption that directors have made an informed decision that they rationally believe to be in the best interests of the corporation, bars courts from reviewing the merits of a business decision. A poor business decision, without more, is not a breach of fiduciary duty, though it may prove more harmful to shareholder interests than a breach of the duty of loyalty. When something goes awry with a corporation, shareholders and their attorneys assume some breach of fiduciary duty must have occurred and look for potential causes of action.

Courts have been fairly realistic about what part-time directors can discover in their monitoring of the firm,[50] requiring only that information and reporting systems be in place that would alert management to a problem should one arise, and that managers pay attention to those sys-

46. *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1640–45 (2001).

47. The Delaware legislature has allowed corporations to exculpate directors from monetary liability for breaches of the duty of care, but not for breaches of the duty of loyalty of failures to act in good faith. DEL. CODE. ANN. tit. 8 § 102(b)(7) (West 2013).

48. *Lyondell*, 970 A.2d at 243–44.

49. Indeed, trust law's "prudent man rule" requires that a trustee manage the assets of a trust as a prudent man would manage his own affairs. Rock Springs Land and Timber, Inc. v. Lore, 75 P.3d 614, 621–22 (Wyo. 2003) (holding a trustee acted in a reasonable and prudent manner by selling trust property); UNIF. TRUST CODE § 804 (2000) ("A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust.").

50. In a 2006 survey, directors, on average, reported spending seventeen hours per month on their board duties. KORN/FERRY INT'L, 33RD ANNUAL BOARD OF DIRECTORS STUDY: CELEBRATING MORE THAN THREE DECADES OF GOVERNANCE ANALYSIS 23 (2006).

tems and respond to red flags.[51] Because of a strong business judgment rule,[52] liability for the duty of care will not attach for poor decision-making absent some significant failure of process.

If one interprets fiduciary duty to mean that the fiduciary must do an extremely careful, competent, and completely selfless job guarding the interests of others, fiduciary obligation is painted far too broadly, and certainly more broadly than it is actually enforced in the corporate context. Understanding fiduciary obligation this way gives the beneficiary a false sense of security, a belief that they are far more protected than they actually are. If shareholders are able to understand the duty more realistically (more narrowly) they may insist upon other protections for indifferent or incompetent performance by directors, or they may demand ways to hold other corporate actors, such as officers, accountable.

The narrower understanding of corporate fiduciary obligation also protects directors from a risk of overwhelming, catastrophic liability. If directors were not assured that they would not be bankrupted for unsuccessful business ventures taken by the firms they manage, they would not take positions on boards (or in C-suites, for that matter) and that would hurt corporations and shareholders alike.[53] It is one thing to require a faithless director to give back gains she took at the expense of the corporation she was supposed to selflessly manage, but quite another to ask a director to come up with millions and millions of dollars to cover losses the corporation realized because of a violation of law or business failure. Disgorgement, the remedy for a breach of the duty of loyalty, is not as frequently catastrophic as compensatory damages, the remedy for other injuries. Corporate directors would agree to owe fiduciary duties, understanding that they constitute an obligation to refrain from indulging self-interest in managing assets, and that ill-gotten gains will be disgorged. Directors likely would not agree to "fiduciary" obligation, an obligation to be selfless, beyond that.

The corporate duty of care falls well short of what one would consider a heightened "fiduciary" standard. Even if it were more rigorous, it would not be frequently enforced as directors are largely exculpated from personal, monetary liability for breaches of the duty of care. The corporate standard of care gives plaintiff shareholders little comfort. It also removes corporate directors from the aspirational view of fiduciary obligation where the fiduciary zealously pursues the best interest of an-

51. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 972 (Del. Ch. 1996) (approving a settlement agreement for violation of federal insurance law that imposed no personal liability for directors when the directors did not intentionally disobey the law and had no specific reason to believe that their monitoring program was inadequate to prevent illegality).

52. The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

53. E. Norman Veasey, *Corporate Governance and Ethics in a Post Enron/Worldcom Environment*, 72 U. CIN. L. REV. 731, 734 (2003) ("There must . . . be a balancing of director accountability with the need to encourage qualified, conscientious and honest people to serve as corporate directors.").

other. Shareholders are not powerless, however. They have other tools at their disposal and the market has designed other mechanisms to constrain the agency costs in corporate governance.

3. Alternative Governance Mechanisms

Corporate officers and directors are subject to a number of governance devices designed to limit agency costs. For instance, the market for corporate control provides a mechanism to replace managers who are performing poorly.[54] In the same vein, corporate directors are concerned about their reputations in the corporate executive community. Most directors are CEOs of other firms. Poor performance in a CEO position or directorship can reduce the likelihood an executive will receive similar opportunities in the future. Shareholders can use their voting rights to change the board of directors and approve or disapprove of potential conflicts of interests those board members might have. Also, creditors play an important role in monitoring the managers of firms with debt. Shareholders often free-ride on the monitoring creditors can do, relying on those creditors to exercise more control over the firm and alert the market when the firm is in financial trouble by declaring a default or taking some other action to try to remove or replace underperforming managers.[55] Ribstein insisted that fiduciary duties were only appropriate where other mechanisms for managing the fiduciary relationship were not available. It would appear that corporate governance has developed mechanisms to constrain agency costs that are more effective than the enforcement of weak corporate fiduciary duties.

Incentive compensation provides a key example. Corporations have increasingly relied on incentive compensation to align managers' interests with those of shareholders.[56] Incentive compensation for corporate managers, and, to a lesser degree, even corporate directors, poses an interesting question for corporate fiduciary obligation. The purpose of incentive compensation is to give managers a stake in the corporation's financial success. Managers, then, are encouraged to consider self-interest in deciding what course of action the corporation should take. It is hard to see how someone can have an obligation to be completely self-

54. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965) (explaining that if a company's stock price decreases due to inefficient management, another entity may take it over and operate it more efficiently).

55. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1212 (2006) ("Loan covenants now are the principal mechanism for handling one of the most challenging problems in corporate governance, the one that arises when a once-effective manager needs replacing and the operations of the business must go through a fundamental overhaul."); Charles K. Whitehead, *Creditors and Debt Governance*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 68, 70 (Claire A. Hill & Brett H. McDonnell eds., 2012) (arguing that since loan covenants usually require companies to make payments, managers are motivated to maximize profitability to avoid bankruptcy or a lower stock price).

56. This is particularly true since Congress amended the Tax Code to only allow corporations to take deductions for salaries under $1 million. Any compensation over that amount must be tied to performance in order to be deductible. I.R.C. § 162(m) (2012); Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 879 (2007).

less when so much of their compensation arrangement depends on operating the firm with a strong consideration of personal financial interest. It is impossible to have it both ways.

The use of incentive compensation should remove corporate management from Ribstein's fiduciary realm, because the managers would have "corresponding economic rights"[57] and an incentive to consider, not renounce, thought of self. Incentive compensation may be a great alternative to "complete selflessness," but it cannot be part of a regime of complete selflessness. Indeed, scholars have expressed concern that managers have allowed their interest in incentive compensation to dominate their judgment about what the best course of action is for a corporation's long-term health.[58] On the other hand, if we limit our understanding of the duty of loyalty to "don't be . . . conflicted without permis-permission,"[59] then fiduciary obligation and incentive compensation can sit side by side.

B. Uncorporations

Unincorporated firms, which Ribstein dubbed "uncorporations," have developed to respond to some of the perceived weaknesses of corporate governance.[60] Different entrepreneurs may have different needs when it comes to organizing the governance of their business, and so may choose different business forms. A number of distinct business forms are in regular use now, from the general partnership to the public corporation, with many hybrids of the two poles in between. These business forms also offer alternatives to fiduciary obligation.

While partners are widely understood by scholars and courts to owe each other fiduciary duties, even the Uniform Partnership Act says so,[61] Ribstein fervently and convincingly argued that partners are not fiduciaries based on the application of his fiduciary theory.[62] Partners, he argued, are owners; owners may not be allowed to misappropriate partnership property, but they are not obliged to renounce all thought of self.[63] Ribstein was able to show, from a theoretical perspective, every supposed "breach" of partnership fiduciary duties can be recast as some

57. Ribstein, *Fencing*, *supra* note 1, at 901.

58. Frederick Tung, *Pay for Banker Performance: Structuring Executive Compensation for Risk Regulation*, 105 NW. U. L. REV. 1205, 1206–07 (2011) (explaining that equity based incentive pay encourages risky behavior because managers profit when a risky investment succeeds but creditors bear the losses when the investment fails); David I. Walker, *The Challenge of Improving the Long-Term Focus of Executive Pay*, 51 B.C. L. REV. 435, 435–36 (2010).

59. Alces, *Debunking*, *supra* note 41.

60. RIBSTEIN, *supra* note 1

61. UNIF. P'SHIP ACT § 404(a) (1997) ("The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care . . . .").

62. Ribstein, *Are Partners Fiduciaries*, *supra* note 1, at 237–38 ("Although partners generally have significant governance powers . . . they do not have fiduciary-like open-ended management power to manage the firm on behalf of passive members. Only *managing* partners in partnerships with centralized management and partners who act as *agents* should be deemed to have fiduciary duties.").

63. *Id.* at 241–42.

other tort or breach of nonfiduciary duty. Thus, he argues, partners are not fiduciaries and not bound to be selfless in their use or control of partnership property.[64] As both the owners and managers themselves, they cannot be owners who have delegated control over their property to someone else.[65] Thus, they do not fit within Ribstein's paradigmatic case for fiduciary relationships.

Other scholars, Ribstein, courts, and the UPA all agree that partners are free to modify by contract the fiduciary duties owed to each other.[66] The UPA is a set of default rules, so partners are free to form whatever agreement suits them and may contract around the vast majority of the UPA provisions. While the UPA does not explicitly allow partners to waive their fiduciary duties entirely, and it is unclear whether courts would uphold such waivers if they were attempted, partners can do a lot to define the limits of their fiduciary obligation including excepting certain circumstances from fiduciary obligation. This flexibility of form is a defining feature of uncorporations.

Most striking are the recent developments in Delaware LLCs that may allow parties to opt out of fiduciary duties entirely.[67] LLCs can be managed by their owners, or members, hired professional managers.[68] Members may owe fiduciary duties to each other in member-managed firms, and managers may owe fiduciary duties to the members in manager-managed firms.[69] While it is taking some time for most courts to adjust to the complete waivability of fiduciary duties in business associations,[70] Delaware courts have led the way in making clear that fiduciary duties are not mandatory in LLCs.[71] Many parties have chosen to waive fiduci-

---

64. *Id.* at 241–44.

65. *Id.* at 237–38.

66. *See, e.g.*, Wilson v. Button, 404 F.2d 309, 310 (5th Cir. 1968) (holding a partner could withdraw funds from the partnership while the partnership was insolvent because the partnership agreement allowed him a salary); Murphy v. Gutfreund, 583 F. Supp. 957, 971 (S.D.N.Y. 1984) (finding a partner did not breach his fiduciary duty by taking a substantial profit at the time of dissolution because he did not violate the partnership agreement); Singer v. Singer, 634 P.2d 766, 772 (Okla. App. 1981) ("We find the defendants had a contract right to do precisely what they did, namely, compete with the partners of Josaline and with Josaline itself 'as if there never had been a partnership.'"); UNIF. P'SHIP ACT § 103 (1997) ("Except as otherwise provided in subsection (b), relations among the partners and between the partners and the partnership are governed by the partnership agreement. . . . The partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty . . . . "); RIBSTEIN, *supra* note 1, at 172–77 (discussing ways that partnership law allows contractual alteration of fiduciary duties in specific types of partnerships); Easterbrook & Fischel, *supra* note 19, at 432–33 ("The duty of loyalty is commonly relaxed because partners often do not commit full time to venture. . . . The duty of care is the negligence rule. All rules are freely variable by contract . . . . "); Frankel, *Default Rules*, *supra* note 26, at 1237–38 (discussing that in certain circumstances, parties can bargain to change fiduciary duties).

67. RIBSTEIN, *supra* note 1, at 177 ("[T]he Delaware LLC statute includes the same provision for wide-open opt-out as the Delaware limited partnership statute.").

68. *Id.*

69. *Id.*

70. *See id.* at 177–78.

71. *Id.* ("Indeed, one of the strongest applications of Delware's freedom of contract approach is in the LLC case of *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, in which the court enforced an operating agreement provision waiving the right to bring an action for judicial dissolution.").

ary duties entirely, or to limit or carefully define them.[72] The fact that parties are willingly and knowingly choosing to eschew fiduciary obligation shows that fiduciary duties are not necessary to protect business owners and that other mechanisms may be just as effective, if not more effective, especially when owners are more attentive to management.[73]

Fiduciary duty in business association law is dying a slow death, but that does not mean directors or other managers are a heartbeat away from being able to use the assets of the businesses they manage as their own without regard to others. We are not in danger of returning to the days of Ross Johnson and RJR Nabisco, far from it.[74] Other mechanisms have grown to make up for the atrophy of fiduciary obligation, giving shareholders and other owners more reliable, less costly ways to discipline managers. Ribstein would argue that where other mechanisms are as or more effective, fiduciary obligation is not appropriate. Even if one thinks that the presence of other disciplining tools is not enough to justify removing a relationship from the fiduciary realm, it is clear that courts, business owners and managers, and state legislatures are becoming less comfortable with the use of fiduciary duties to mediate the relationships in business associations.

IV. Implications For Future Research

The decline of fiduciary obligation in business associations does not mean that fiduciary relationships themselves are on the decline, however. There are still a host of situations in which parties may strongly prefer the use of fiduciary duties, relationships that are firmly at the "fiduciary" end of the Easterbrook/Fischel continuum,[75] where the entrustor really is unsophisticated and vulnerable to the power and judgment of the fiduciary.[76] While Ribstein would disagree that many of these relationships should be fiduciary, we can use his argument that fiduciary obligation should be narrowly and predictably applied to explain how to make the use of fiduciary obligation in these relationships most effective.

If parties can choose contractually whether or not to enter into a fiduciary relationship, then they may choose to use fiduciary duties even in situations Ribstein finds inappropriate for fiduciary relationships. Respect for market forces and rational decision-making should support the use of fiduciary obligation by willing parties. Indeed, there are situations more delicate than the management of property in which beneficiaries may want to fill the gaps with a promise from the other party to abstain

72. *See id.*

73. *Id.*

74. RJR Nabisco's CEO, Ross Johnson, was notorious for using corporate funds for executive perks. During his tenure, RJR Nabisco paid for corporate executives to golf with celebrities and maintained an "air force" of private jets to carry executives to personal vacations. BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO 91–96 (1990).

75. Easterbrook & Fischel, *supra* note 19, at 438 (arguing that contractual relationships are only fiduciary where it is prohibitively expensive to negotiate the necessary terms).

76. Frankel, *supra* note 20, at 808.

from undisclosed conflicts of interest in the performance of a given task. Not only do private parties recognize the large gaps in monitoring and relative vulnerability in certain relationships, but the law has become accustomed to enforcing fiduciary obligation in those relationships.

For example, the attorney-client relationship is often described as one that is traditionally fiduciary.[77] The law is accustomed to requiring that attorneys zealously pursue their clients' interests and that they not indulge interests that may conflict with those of a particular client without first disclosing the potential conflict to the client and receiving the client's approval. There are some conflicts that cannot be overcome by the client's permission where the conflicted attorney would have to avoid the conflict entirely or quit the representation of the client. Law firms vigorously monitor potential conflicts between attorneys and clients. The rules of professional responsibility go to great lengths to define the appropriate standard of conduct for attorneys and describe what constitutes a conflict and how an attorney, law firm, and client should handle it. These strictly enforced standards of conduct cover every facet of the attorney-client relationship and leave very little to chance in a court's *ex post* determination of whether an attorney has breached her fiduciary duties. While fiduciary duties may apply to the relationship and zealous advocacy is clearly required, the obligation an attorney owes a client is not left to vague, unpredictable *ex post* judicial review. It is quite thoroughly described in codes of conduct that have grown ever more complete and sophisticated over time.

While not all fiduciary relationships are governed by codified standards of conduct, they tend to have a rich body of law supporting their use and rendering them easier to administer. Fiduciary duties may be able to respond to unanticipated situations, but they are not unpredictably applied. This judicial gap filling helps fiduciaries to understand their obligations and makes them more comfortable entering into a fiduciary relationship in the first place. The better fiduciaries understand their obligations, the less likely they are to run afoul of them. The clarification of what fiduciary obligation means in particular circumstances helps to simplify the duty and makes it easier to enforce.

This effective simplification is in line with Ribstein's view of fiduciary duties as a relatively narrow contract term. While Ribstein calls the remedy of fiduciary obligation "strong medicine," he describes the duty of loyalty in narrow terms related to avoiding conflicts of interest relating to the specific fiduciary task. If fiduciary obligation is a narrow, "fenced," contract term, then it can be added to a variety of contracts and easily and relatively predictably enforced.

---

77. DeMott, *supra* note 33, at 912; D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1461–62 (2002) ("In the attorney-client context, for example, fiduciary duty claims usually arise in two contexts. The first involves cases where the attorney engages in a business transaction with the client . . . . The second context is cases where the attorney seeks personal gain by using or disclosing confidential information of the client . . . .").

The theory advanced in this Article turns Ribstein's theory on its head, then—it advocates narrowly understood fiduciary duties in a wide variety of situations where Ribstein argued that a broad, extreme theory of loyalty be used only sparingly. This new theory avoids the indeterminacy involved if one casts fiduciary obligation as a means to cause strangers to treat each other as something else. It is best if strangers remain on guard when dealing with strangers, even if the fiduciary stranger agrees to be bound by a term whereby he has to eschew self-interest with regard to a particular transaction or task. We will never know what lies in a fiduciary's heart and we can only enforce what we can see. We limit the enforcement of the duty of loyalty to disgorgement of ill-gotten gains, and do not provide a remedy for all of the ways a fiduciary could be disappointing or lazy or a "bad guy." The market for fiduciary services and reputation and other such mechanisms must step in to perform those tasks. This understanding of the limited role of fiduciary obligation is also consistent with Ribstein's position on trust. We cannot legally force people to be "good" to one another. We cannot force them even to be completely faithful. We can only be sure that they do not profit from conflicted interests when they agree not to.

Future research should take the lessons Ribstein's work has given us and look for the proper role, and definition, of fiduciary obligation in a variety of contexts. His caution about "fencing" the scope and nature of fiduciary obligation can help us use it and apply it better in instances where parties agree that it is a term to which they want to be bound. Combining a well-established knowledge of the instances in which parties find fiduciary obligation most helpful may lead us to the path toward the most effective use of fiduciary relationships in the future.

V. CONCLUSION

Larry Ribstein encouraged scholars and courts to "fence" fiduciary duties. That is, to understand that there is only one truly fiduciary duty, the duty of loyalty, and that duty commands selflessness, defined by an avoidance of conflicts, only in particular situations. He argued that fiduciary duties are only appropriate where an owner of property delegates open-ended control over that property to another. His narrow view of fiduciary obligation is well supported in the use and enforcement of fiduciary obligation in business associations. Fiduciary obligation in business association governance is growing increasingly obsolete as other mechanisms rise up to take its place.

Other scholars have encouraged us to have a broader understanding of fiduciary obligation and to apply it in a variety of settings where one party allows herself to be vulnerable to the power or judgment of another. We can take important lessons from both views. Ribstein's view of fiduciary duty as a contract term that should be applied carefully allows us to see it as a term that can be freely added to any number of relationships and it is most useful when it is best understood. A narrow, relatively specific understanding of the duty of loyalty would help to best strike this balance so that parties fully comprehend the consequences and requirements of the term they are adopting. A narrow understanding of what fiduciary duties are, then, allows parties to import them into a variety of situations in which one party may be vulnerable to the judgment of another.