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THE PRICE OF TRUST: AN EXAMINATION OF FIDUCIARY DUTY AND THE LENDER-BORROWER RELATIONSHIP

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Comparing the search for elements which will give rise to a fiduciary relationship between a bank and a borrower to the quest for the elusive holy grail, Professor Hunt proposes that, rather than existing only in special circumstances, the fiduciary relationship is a normal aspect of the bank-borrower relationship. Hunt explains that a fiduciary obligation is part of the parties' assumptive base in the bank-borrower relationship that must by necessity exist before any borrower would entrust private or business information to a bank in return for a loan. While acknowledging that such a relationship might be inapposite in the initial bargaining process of the relation, since the parties are adverse at this time, Professor Hunt demonstrates that there is no such impediment existing when the parties move into the next phase of their relationship — the servicing and processing of the agreement. Professor Hunt further argues that recognition of a fiduciary relationship at this phase of the bank-borrower relationship would be beneficial not only to the parties involved, but to society as a whole by providing more protection to borrowers, and thus encouraging more participation from the public in the banking industry at a minimum of cost and disruption to the traditional relationship between the parties.

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INTRODUCTION

The booming field of lender liability has virtually revolutionized the conventional relationship between borrowers and lenders.[1] In contrast to their traditionally passive role in the debtor-creditor relationship,[2] borrowers have recently become uncharacteristically aggressive and adversarial, bringing suit against their lenders with increasing frequency.[3]

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1. Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131, 131-33 (1989). Professor Fischel points out that

> [i]n an increasing number of other well-publicized trials, juries—and occasionally courts in non-jury trials—have awarded borrowers staggering amounts in lender liability suits against banks. While some of these verdicts have been reversed on appeal, the basis for reversal in these cases has been limited to the facts of each case. The area of lender liability remains a booming area of intense concern to lenders and students of commercial law.

Id. at 133.

2. 5A MICHIE ON BANKS AND BANKING I (1994).

3. *See generally* Werner F. Ebke & James R. Griffin, *Lender Liability to Debtors: Toward a Conceptual Framework*, 40 SW. L.J. 775 (1986) (examining the possibility of a balance between the interests of lenders and debtors by focusing on the impact of common law theories on lender liability resulting from alleged misconduct); Lawrence F. Flick, II & Dennis Replansky, *Liability of Banks to Their Borrowers: Pitfalls and Protections*, 103 BANKING L.J. 220 (1986) (describing the theories of lender liability, state and federal liability statutes, and lender protection from liability); Loeb H. Granoff, *Emerging Theories of Lender Liability: Flawed Applications of Old Concepts*, 104 BANKING L.J. 492 (1987) (arguing that lender liability is nothing more than misapplication of tort and contracts law); Debra Cassens Moss, *Borrowers Fight Back with Lender Liability*, A.B.A. J., Mar. 1987, at 65 (examining judgments holding lenders liable for unfair treatment of borrowers); PRACTIC-

Many such borrowers have enjoyed a considerable degree of success in the courts, often with quite spectacular results.[4]

In achieving these results, borrowers have not relied on a single theory of liability,[5] but rather they have employed a wide range of theories, including federal statutes[6] and the creative use of such traditional com-

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ING LAW INSTITUTE, LENDER LIABILITY LITIGATION: RECENT DEVELOPMENTS (1987) (examining recent developments in lender liability litigation through several different articles); John O. Tyler, Jr., *Emerging Theories of Lender Liability in Texas*, 24 HOUS. L. REV. 411 (1987) (suggesting that traditional contract and tort law are appropriate means for addressing the failure of lenders to exercise good faith in dealings with borrowers); John J. Walsh, *Common Law Claims Against Lenders, in* LENDER LIABILITY LITIGATION: RECENT DEVELOPMENTS at 9, 14-40 (PLI 1988) (discussing lender liability and common law claims such as misrepresentation, economic duress, tortious interference, negligence, breach of contract, breach of fiduciary duty, excessive control, intentional infliction of emotional distress, and general tort liability); James R. Borders, Note, *The Growth of Lender Liability: An Economic Perspective*, 21 GA. L. REV. 723 (1987) (examining three cases that show lenders' contractual obligations to borrowers who default and must return the principal); Mark Snyderman, Comment, *What's So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending*, 55 U. CHI. L. REV. 1335 (1988) (discussing the concept of good faith performance in commercial lending); James Mabry Vickery, Note, *A Special Relationship: The Use of the Duty of Good Faith and Fair Dealing to Impose Tort Damages in Contracts Between Lender and Borrower*, 9 REV. LITIG. 93 (1990) (examining the elements of a cause of action in tort between a lender and borrower and situations in which courts have found that the lender violated the duty of good faith and arguing against the application of the duty of good faith to commercial lending); Sarah Barlett, *Borrower v. Banker: The Newest Lawsuit in Town*, BUS. WK., July 14, 1986, at 59 (examining the lender liability phenomenon).

4. *See* Fischel, *supra* note 1 (describing the awards to borrowers as "staggering"). *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (affirming a $75 million dollar jury verdict in favor of the borrower); Penthouse Int'l v. Dominion Fed. Sav. & Loan Ass'n, 665 F. Supp. 301 (S.D.N.Y. 1987), (awarding $130 million) *modified by* 885 F.2d 963 (2d Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) (affirming a jury verdict of over $18.5 million dollars).

5. *See* Paul M. Jones, Comment, *Good Faith Theories of Lender Liability*, 48 LA. L. REV. 1181 (1988) (pointing out that while all of the cases brought by borrowers under these various claims of action "loosely coalesce under the term 'lender liability'. . . that term denotes more than a collective reference to theories of law; it describes a marked tendency of courts to apply well-established theories of law to the lender-borrower relationship for the first time"). *See also* Ebke, *supra* note 3, at 813 (examining the need for a conceptual reorientation of lender liability); MELRYN L. CANTOR ET AL., *Lender Liability Theories, in* LENDER LIABILITY LITIGATION: RECENT DEVELOPMENTS 71, 74 (PLI Com. L. & Practice Course Handbook Series No. A4-4200, 1987) (explaining that borrowers use traditional theories of liability to prove lender liability); Fischel, *supra* note 1, at 133 (arguing that "[l]ender liability cases have led to the creation of an area of commercial law that has not been accompanied by the development of a coherent theoretical framework establishing the rights of lenders and their duties to their borrowers") (footnote omitted).

6. *See* Sanford M. Litvak & Eric J. Lobenfeld, *Lender Liability Litigation, Recent Developments: Claims under Federal Law, RICO, Antitrust and Bank Holding Company Act, in* LENDER LIABILITY LITIGATION: RECENT DEVELOPMENTS 247, 249 (PLI Com. L. & Practice Course Handbook Series No. 386 (1987)). *See also* Roark M. Reed & Terrance G. Reed, *Lender Liability Under the Racketeer Influenced and Corrupt Organizations Act, in* LENDER LIABILITY LAW AND LITIGATION (MB) ch. 9 (1994) (discussing the use of RICO's civil cause of action); United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990) (holding that the creditor of the corporation may be liable under CERCLA), *cert. denied*, 498 U.S. 1046 (1991); Schlifke v. Seafirst Corp., 866 F.2d 935 (7th Cir. 1989) (applying federal

mon law claims as negligence,[7] fraud, and negligent misrepresentation,[8] breach of contract,[9] duress,[10] interference with contractual relations,[11] excessive control,[12] waiver,[13] breach of the obligation of good faith,[14] and breach of fiduciary duty.[15] To date, the claim that lenders owe a duty to act in good faith and are liable for its breach has received the majority of attention and acceptance by both scholars[16] and judges.[17] Conversely, the

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securities laws in making a judgment); Morosani v. First Nat'l Bank of Atlanta, 703 F.2d 1220 (11th Cir. 1983) (holding that the act of a bank improperly charging excessive interest clearly fell within the requirements of a violation of RICO); United States v. Nicolet, 712 F. Supp. 1193 (E.D. Pa. 1989) (holding that the holder of a mortgate could be liable for response costs under CERCLA); National Union Fire Ins. Co. v. Eaton, 701 F. Supp. 1031 (S.D.N.Y. 1988) (dismissing a counterclaim alleging the insurance company aided and abetted the limited partnership's federal securities law violations); *In re* Rubin Bros. Footwear, Inc., 73 B.R. 346 (Bankr. S.D.N.Y. 1987) (holding that plaintiffs' claim against lender was valid under RICO); Odesser v. Continental Bank, 676 F. Supp. 1305 (E.D. Pa. 1987) (holding that manipulation of cash flow, fraudulent loan agreements, and other financial maneuvers constituted a cause of action under RICO); LSC Assoc. v. Lomas & Nettleton Fin. Corp., 629 F. Supp. 979 (E.D. Pa. 1986) (holding that a claim against a lender under RICO was valid).

7. *See* Bevier v. Production Credit Ass'n, 429 N.W.2d 287 (Minn. Ct. App. 1988). *See also* Connor v. Great Western Sav. & Loan Ass'n, 447 P.2d 609 (Cal. 1968) (holding that bank had a duty to exercise care to prevent the construction and sale of defective houses and was liable for damages); Small v. South Norwalk Sav. Bank, 535 A.2d 1292 (Conn. 1988) (accepting theory that the bank owed a duty to the mortgagee and the breach of that duty amounted to negligence); Jacques v. First Nat'l Bank, 515 A.2d 756 (Md. 1986) (holding that bank owed customer a duty of reasonable care in processing and deciding on a loan application).

8. *See* Central States Stamping Co. v. Terminal Equip. Co., 727 F.2d 1405 (6th Cir 1984); Barrett v. Bank of Am., 229 Cal. Rptr. 16 (Ct. App. 1986) (holding that a constructive fraud against the bank was valid); Richfield Bank & Trust Co. v. Sjogren, 244 N.W.2d 648 (Minn. 1976).

9. *See* Penthouse Int'l v. Dominion Fed. Sav. & Loan, 855 F.2d 963 (2d Cir. 1988). *See also* Landes Const. Co., v. Royal Bank, 833 F.2d 1365 (9th Cir. 1987) (finding that the bank breached an oral agreement to company); Kruse v. Bank of Am., 248 Cal. Rptr. 217 (Ct. App. 1988) (deciding breach of contract issue asserted by growers against bank).

10. *See* Pecos Constr. Co. v. Mortgage Investors Co., 459 P.2d 842 (N.M. 1969).

11. *See* State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex Ct. App. 1984); *See also* Melamed v. Lake County Nat'l Bank, 727 F.2d 1399 (6th Cir. 1984) (deciding claims of tortious interference of business relationships by bank).

12. *See State Nat'l Bank*, 678 S.W.2d at 661.

13. *See* Nevada Nat'l Bank v. Huff, 582 P.2d 364 (Nev. 1978).

14. For a list of sources addressing a breach of the obligation of good faith, see *infra* notes 16 and 17.

15. For a list of sources addressing a breach of fiduciary duty, see *infra* notes 16 and 17.

16. William Warren, *Good Faith and Fair Dealing Under the Uniform Commercial Code*, in EMERGING THEORIES OF LENDER LIABILITY 59 (H. Chaitman ed. 1985). *See also* K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (holding that lender may have an implied obligation of good faith to borrower); Kruse v. Bank of Am., 248 Cal. Rptr. 217 (Ct. App. 1988) (holding that debtors failed to establish cause of action for breach of good faith obligation of contract), *cert. denied* 488 U.S. 1043 (1989); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex Ct. App. 1984) (holding that creditor had committed fraud and interferred with debtor's business); Alan A. Blakeboro & Rex Heeseman, *Good Faith Duties and Tort Remedies in Lender Liability Litigation*, 15 W. ST. U.L. REV. 617 (1988)

least accepted and most severely criticized theory of lender liability has been that lenders owe fiduciary duty to their borrowers and are liable for its breach.[18] This article will examine this much maligned and little understood area of lender liability—liability based on the existence and breach of a fiduciary duty.

A careful review of the case law in this area reveals that where bor-

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(examining tort remedies for bad faith breach of contract in commercial cases and application in lender liability litigation); John O. Tyler, Jr., *Emerging Theories of Lender Liability in Texas*, 24 HOUS. L. REV. 411 (1987) (examining good faith doctrine and lender liability); Jonathan K. Van Patten, *Lender Liability: Changing or Enforcing the Ground Rules*, 33 S.D. L. REV. 389 (1988) (examining the theories used by borrowers in lender liability as well as defenses in collection or foreclosure actions); Glenn D. West & Michael P. Haggerty, *The "Demandable" Note and the Obligation of Good Faith*, 21 U.C.C. L.J. 99 (1988) (addressing the obligation of good faith accompanying a note); Cheryl Anderson, Note, *Lender Liability: Breach of Good Faith in Lending and Related Theories*, 64 N.D. L.REV. 273 (1988) (addressing lender liability theory for lack of good faith); Jill Pride Anderson, Comment, *Lender Liability for Breach of the Obligation of Good Faith Performance*, 36 EMORY L.J. 917 (1987) (discussing the good faith obligation and its use to limit a lender's ability to exercise contractual rights and remedies); Sandra Chutorian, Note, *Tort Remedies for Breach of Contract: The Expansion of Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing into the Commercial Realm*, 86 COLUM. L. REV. 377 (1986) (arguing against a tort for breach of the implied covenant of good faith and fair dealing as a solution to the problem of bad faith conduct in the performance and termination of contracts); John Monaghan, Note, *Extending the Bad Faith Tort Doctrine to General Commercial Contracts*, 65 B.U. L. REV. 355 (1985) (examining the "bad faith" doctrine in light of *Seaman's Direct Buying Serv. v. Standard Oil Co.* and suggesting a standard for applying the doctrine); James Mabry Vickery, Note, *A Special Relationship: The Use of the Duty of Good Faith and Fair Dealing to Impose Tort Damages in Contracts Between Lender and Borrower*, 9 REV. LITIG. 93 (1990).

17. *See* Paul Matthew Jones, Comment, *Good Faith Theories of Lender Liability*, 48 LA. L. REV. 1181 (1988). *See also* N.E. Betsworth, Note, Commercial Cotton Co. v. United California Bank: *California's Newest Extension of Bad Faith Litigation Into Commercial Law*, 16 SW. U. L. REV. 645 (1986) (discussing the use of a breach of good faith in commercial banking law in a California case); James H. Cook, Comment, Seaman's Direct Buying Service, Inc. v. Standard Oil Co.: *Tortious Breach of the Covenant of Good Faith and Fair Dealing in a Noninsurance Commercial Contract Case*, 71 IOWA L. REV. 893 (1986) (proposing guidelines for the adoption of good faith doctrine in a noninsurance commercial contract case); Steven H. Hilfinger, Note, K.M.C. Co. v. Irving Trust Co.: *Discretionary Financing and the Implied Duty of Good Faith*, 81 NW. U. L. REV. 539 (1987) (discussing the parameters of the good faith obligation imposed on lenders); Patricia A. Milon, Recent Development, *Implied Covenants of Good Faith and Fair Dealing: Loose Canons of Liability of Financial Institutions?*, 40 VAND. L. REV. 1197 (1987) (exploring the judicial applications of the duty of good faith and fair dealing to the activities of lenders in order to formulate standards by which future lender liability suits might be assessed).

18. *See* Fischel, *supra* note 1, at 146-47 (arguing that the imposition of a fiduciary duty on lenders is inappropriate in the typical lender liability case); *See also* Van Patten, *supra* note 16, at 409-10 (arguing that "of all the theories of lender liability, the assertion of a claim or defense based upon a breach of fiduciary duty by the lender has met with the least success. In other words, most lender liability situations will not justify use of this theory"). *But see* Barrett v. Bank of Am., 229 Cal. Rptr. 16 (Ct. App. 1986) (stating that a lender may have a fiduciary duty to its borrower); Barnett v. Hooper, 498 So. 2d 923 (Fla. 1986) (holding that bank owes a fiduciary duty to its customers); Deist v. Wachholz, 678 P.2d 188 (Mont. 1984) (holding that bank had a fiduciary duty to vendor for whom it acted as financial adviser).

rowers have asserted lender liability claims based on the theory of a breach of a lender's fiduciary responsibilities, the results have been mixed.[19] Courts have found the existence and breach of fiduciary duties in particular circumstances, but have denied either their existence or their breach in others. However, with relatively few exceptions,[20] courts have generally found that there is no inherent inconsistency in the existence of a fiduciary relationship between borrowers and lenders, notwithstanding their traditional arm's-length roles as debtor and creditor.

This author's main concern with such judicial decisions, which is reflected in academic scholarship,[21] is the underlying presumption that a fiduciary relation between a borrower and a lender is an exceptional, rather than a normal and characteristic feature of the relationship. Because of this unfortunate presumption, it is widely believed that, although it may be "possible" for a fiduciary relation to exist and span the great divide traditionally believed to separate borrowers from lenders, the existence of such a duty is a rare and exceptional event. Accordingly, many courts and scholars have concluded that the existence of a "special relationship" between borrowers and lenders is a condition precedent to any establishment of a fiduciary relation.[22]

This article argues that this traditional and widely held presumption is fundamentally flawed and demonstrates a misunderstanding of the very nature of the relationship and of the bonding mechanisms[23] inherent in modern commercial transactions[24] between borrowers and lenders.[25] In

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19. For a discussion of the obligation between lender and borrower, see *infra* notes 72-215 and accompanying text.

20. *See* Pardue v. Bankers First Fed. Sav. & Loan Ass'n, 334 S.E.2d 926 (Ga. Ct. App. 1985) (holding that there is no confidential relationship between a lender and borrower and noting that nothing in the statute "impose[d] a fiduciary duty generally upon banks . . . or a duty in particular to advise customers and debtors") (quoting National Bank v. Arnold, 240 S.E.2d 3 (Ga. 1981)). *Id.* at 927.

21. *See, e.g.*, Fischel, *supra* note 1; Van Patten, *supra* note 16.

22. For a list of sources discussing the fiduciary relationship between lenders and borrowers, see *supra* note 18.

23. For a general discussion of bonding mechanisms and their importance to the borrower-lender relationship, see Fischel, *supra* note 1, at 134-40. *See also* Smith & Warner, *On Financial Contracting: An Analysis of Bonding Covenants*, 7 J. FIN. ECON. 117 (1979); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981) (examining relational contracts in which one party has a good faith obligation to carry on activity that is beneficial to the other party).

24. Actually, if taken to their logical conclusion, this article's views on this subject are even more radical than they may at first appear, in that the author does not think that there is anything unique to "modern" commercial transactions that makes fiduciary duties between a lender and a borrower any more normative than in those that came before the so-called "modern" commercial period. By the very nature of the transactional relationship between borrowers and lenders, both today and from the very beginning of organized banking and lending practices, the fiducial relation has always been normative rather than exceptional with respect to many aspects of that relationship. The analysis here is primarily restricted to modern transactions because, due to their highly structured nature, and the significance of the stakes involved, it is especially clear in this context that such a normative

advancing this theory, this article is *not* suggesting that the borrower-lender relationship is wholly and exclusively fiduciary in nature as that which we have long understood to exist between principal and agent.[26] Rather, the article suggests that the borrower-lender relationship, perhaps more than any other commercial relation in contemporary society, has now evolved, in the tradition of Sir Henry Maine,[27] into a dynamic and complex tapestry, combining varying degrees of "status," "contract," and "fiduciary" principles.[28] This article argues that the appropriate

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relation must exist, at least with respect to some aspects of this relationship, and in fact it is fundamental to the existence of the bank lending industry as we know it.

25. All references to the borrower and lender relationship in this article are expressly limited to institutional (primarily banks and savings and loans) rather than private lenders, and commercial rather than residential borrowers. All of the cases and academic commentary which are cited herein, with very rare exceptions, deal primarily with institutional lenders and commercial borrowers. However, this restriction should not raise any inference that the observations and analysis do not apply with at least equal force in the context of the "residential" borrower and institutional lender relationship. On the contrary, this article's observations and analysis regarding the inherent nature of the fiduciary duties which lenders owe to their commercial borrowers, probably would apply with even greater precision, force, and persuasiveness when the borrowers are residential rather than commercial in character. Consequently, this particular aspect of the topic shall be left for a later time in a forthcoming article so as to afford it the full and complete consideration and exploration that it deserves. However, in that forthcoming piece the focus will be not only on the nature of the residential borrowing relationship per se, but in particular will pay close attention to those situations where racial minorities and people of color are concerned.

26. It is axiomatic that such "pure" and exclusive fiduciary duties govern the classic agency relationship. *See* Fischel, *supra* note 1, at 146-47, where Professor Fischel points out that such a "pure" fiduciary relationship is one wherein there is

> an agreement in which one or more persons (the principal[s]) delegate authority to another person (the agent) to perform some service or task on the principal's behalf. Examples of agency relationships in commercial contexts include trustees who manage money on behalf of others and corporate directors. In both cases, fiduciary duties require the agent to act on behalf of the principal.

Id. at 146.

27. SIR HENRY MAINE, ANCIENT LAW, 160-70 (1861).

28. *See* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 797-804 (1983), where Professor Frankel generally describes and compares the important relations of "status," "contract," and "fiduciary" in terms of the following three important features: (1) the contribution of the various relations to the desires and expectations of the parties; (2) how each relation effects negotiating leverage between the parties; and (3) the law's influence on the parties' needs and expectations, vulnerability to coercion, and promotion of the relation. *Id.* at 798.

In Frankel's article, he analyzes these features in their relationship with the relations of status, contract, and fiduciary. In regards to status, the parties to such a relation are forced to rely on each other in order to obtain both needs and desires. Frankel describes this relation in terms of a parent and child, where one party (the Power Bearer) has near or complete control and ability to satisfy the needs of the other (the Dependent). By virtue of his monopoly, the Power Bearer can secure obedience from the Dependent by controlling the satisfaction of the Dependent's needs. In response to this display of power, the Dependent will bow to the Power Bearer in order to survive. The Power Bearer, however, must yield at some point in order to further his interests, and thus gross abuse of power is avoided. Thus, the parties survive in a quasi-symbiotic relationship that is controlled, to a great degree, by the law, for it is the law, not the parties, that determines the beginning and ending of the relation. *Id.* at 798-99.

question is not whether there is generally a fiduciary relation between borrowers and lenders, but rather, whether a fiduciary duty has arisen with respect to a particular aspect of their relationship.[29] If such a duty has arisen, then the next question is whether there is a causal link between the borrower's damages and the lender's breach of its corresponding fiduciary duty. Finally, if the answer to both of the preceding questions is in the affirmative, the question then arises whether, as a matter of policy consistent with the equitable foundations of the fiduciary obligation, the law ought to grant some form of relief to the borrower.

To develop this theory, Section I of this article examines the nature of the fiduciary obligation from four important perspectives: the (a) history, (b) definition, (c) sources, and (d) purpose of fiduciary duties. Section II then examines the case law which has developed determining when and under what circumstances a fiduciary relationship will arise between

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Frankel also explains how contract relates to the aforementioned features. In a contract relation, as in a status relation, the parties must rely upon each other in order to fulfill their needs and desires. However, unlike the parties in a status relation, there is no Power Bearer, and neither party can achieve his goals by use of force or monopoly of means. Rather than a monopoly, a contract relation typifies the normal process associated with the creation of contracts—bargaining and persuading the other party to make an exchange for the benefit of both. It must not be forgotten, however, that the parties are adverse and each must strive to protect his interests from his adversary. *Id.* at 799.

Contrary to parties in a status relation, parties in a contract relation "have many options for satisfying their needs." Needs are determined and evaluated and the parties bargain to obtain them, reaching agreements which may be enforced. "Contract frees each party from domination by the other, making them more independent than in a status relation." *Id.* The price of this freedom, however, is the absence of security, for neither party to the contract has an obligation to care for the other. The function of the law in such relations is to "prohibit the use of force and monopoly, and to enforce the rules the parties freely set for themselves. *Id.* at 800. It does not make the rules or the terms of the contract, but it may serve to "facilitate the bargaining process . . . [and] encourage markets to offer numerous options to each individual from which to satisfy his needs by exchange." Id.

Next, Frankel discusses the way in which the fiduciary relation relates to the denoted features. He begins by explaining that in a fiduciary relation, one party (the Entrustor) is dependent upon the other (the Fiduciary). While this may seem similar to the status relation, the dependence involved in a fiduciary relation is rarely as great as that displayed in status relations. Dependence arises because the Entrustor must rely upon the fiduciary for a particular service. This dependence, however, is balanced by the fact that the Fiduciary does not have a monopoly on the means by which the Entrustor's needs may be satisfied. The Fiduciary does not provide every service the Entrustor may wish. Rather, an Entrustor often has the ability to choose his fiduciary from a group offering such services and may negotiate the terms of the relation. Thus, any chance for a monopoly is usually destroyed. Equality is further strengthened by the fact that the Fiduciary lacks the power to "manipulate the terms of his performance once the relation has been established." *Id.* at 801. "Thus, fiduciary relations combine the bargaining freedom inherent in contract relations with a limited form of the power and dependence of status relations. . . . Accordingly, the law of status and fiduciary relations should, if possible, preserve the best aspects of status and contract relations." *Id.*

29. *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (1988). Professor DeMott argues that, "[a]lthough one can identify common core principles of fiduciary obligation, these principles apply with greater or lesser force in different contexts involving different types of parties and relationshipships. . . . the law of fiduciary obligation is situation-specific." *Id.* at 879.

a commercial borrower and a lender. Section III provides a critique of the law of fiduciary duty between borrowers and lenders as revealed in the case analysis from Section II and based on the discussion in Section I. Finally, Section IV suggests changes in the law which reflect a more enlightened relational model and management regime for the lender-borrower relationship. This model more closely reflects contemporary social values, the reasonable and foreseeable expectations of today's commercial players, and the needs of the banking industry and society as a whole.

I. THE NATURE OF THE FIDUCIARY OBLIGATION

It is important to note as a threshold consideration that the term "fiduciary obligation" and its adjective progeny[30] are extremely elusive concepts and, as such, are "particularly resistant to precise definition."[31] However, a clear and comprehensive definition of the term and an understanding of the concepts embodied within is essential to the development of the proposed model in this article.

Any meaningful attempt to comprehend the true nature of "fiduciary obligations" or of gaining a workable grasp of the character of the obligation's "fabric" must consider the following four areas: (1) historical development, (2) definitional intricacies, (3) distinct sources, and (4) the unique purposes which the obligation serves in complex commercial relations.[32] It is necessary to examine these four areas because only in this way can we hope to fully appreciate the tremendously "unprecedented expansion and development of fiduciary law"[33] in recent time and its sig-

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30. Most significant among such adjectival developments is the so-called "fiduciary duty." For a more complete discussion of the process of defining fiduciary obligation in such adjectival terms see, R.P. MEAGHER, ET. AL., EQUITY: DOCTRINES AND REMEDIES 130-60 (2d ed. 1984). *See generally* Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U. L. REV. 1 (1985) (discussing fiduciary duty).

31. DeMott, *supra* note 29, at 881 (describing fiduciary obligation as "one of the most elusive concepts in Anglo American law"). *Id.* at 879. *See also, e.g.*, Steelvest, Inc. v. Scansteel Serv. Ctr., Inc. 807 S.W.2d 476 (Ky. 1991) (concluding that "because the circumstances which may create a fiduciary relationship are so varied, it is extremely difficult, if not impossible, to formulate a comprehensive definition of it that would fully and adequately embrace all cases"). *Id.* at 485.

32. It has been persuasively and insightfully argued that the basic relations in our society have evolved from status, to contract, to fiduciary relations. For example, Professor Frankel has written that "a major reason for recognizing and developing a separate body of fiduciary law is that our society is evolving into one based predominantly on fiduciary relations. The body of lay governing fiduciary relations can affect and be affected by this social trend." Frankel, *supra* note 28, at 798. Professor Frankel further notes that

> we are witnessing the emergence of a society predominantly based on fiduciary relations. This type of society best reflects our contemporary social values. In our society, affluence is largely produced by interdependence, but personal freedom is cherished. Society's members turn to an arbitrator, the government, to obtain protection from personal coercion by those on whom they depend for specialized services. A fiduciary society attempts to maximize both the satisfaction of needs and the protection of freedom.

Id. at 802 (footnote omitted).

33. *Id.* at 796.

nificance for managing the borrower-lender relationship in a way which more closely reflects contemporary social values and commercial expectations.

A. *The Historical Development of Fiduciary Obligation*

The concept of fiduciary obligation has its legal origins in equity, through the English Court of Chancery. The chancery court's sole purpose was to reflect the conscience of the King as seen through the moral considerations of the dictates of the church.[34] Through this court's broad grant of equitable jurisdiction, the Chancellor was empowered to grant relief to petitioners where the law courts could not.[35] Thus, the chancery court could temper; correct; and, to the extent required by the equities of particular cases, supplement the often harsh results mandated by "law."[36] Such a system empowered the Chancellor to use his discretion in order to fashion remedies based on broad principles of morality, considering what was "right" and equitable in light of the then-existing community values.[37] Consequently, the court of Equity, rather than being bound by re-

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34. FLEMING JAMES, JR. & GEOFFREY C. HAZARD, JR., CIVIL PROCEDURE § 1.6 (3d ed. 1985).

35. *Id.* §§ 1.4-1.5.

36. *Id.* This equitable bifurcation of jurisdiction and authority has been continued to this day by many modern American court systems. *Id.* §1.5. Most notably, in the state of Delaware (the state of incorporation for the vast majority of many American corporations) the most prominent corporate law court—Delaware's Court of Chancery—was, and still is today, a separate court of equity, operating with a self-consciously equitable style. *See* DEL. CODE ANN. tit. 10, § 341 (1974). The court has jurisdiction over traditionally equitable matters, such as trusts and guardianship proceedings, as well as all actions in which the plaintiff seeks an equitable remedy. *See* First Nat'l Bank v. Andrews, 28 A.2d 676, 677 (Del. Ch. 1942). However, if the parties have sufficient remedies before any other court, the Court of Chancery "shall not have jurisdiction to determine the matter." DEL. CODE ANN. tit. 10, § 342 (1974). The fact that the Court of Chancery is a court of equity is also apparent by its relationship with the Delaware Supreme Court. It is not unusual for the Supreme Court to formulate rules in opinions which appear to be firm black letter law, but are in fact coupled with express acknowledgments of Chancery's power to vary their application under the circumstances of a particular case. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 815 n.8 (Del. 1984) (acknowledging Chancery's discretionary review in determining excuse of demand requirements in shareholder derivative actions). As a result, although a rule itself may not be explicitly discretionary, discretion in interpretation and enforcement arises from the institutional fact that Chancery is a court of equity. "The perceived quality of Delaware's Chancery Court as a forum for corporate litigation provides a conventional justification for Delaware's attractiveness as a situs for incorporation. This fact might well cause one to question the wisdom of abolishing courts of equity in other jurisdictions." DeMott, *supra* note 29, at 881 n.9. *See generally* JAMES, *supra* note 34, § 1.6 (3d ed. 1985) (discussing the development and history of the parallel court systems of law and equity and their subsequent merger in many jurisdictions into a single court system).

37. *See* RENE DAVID & JOHN E.C. BRIERLEY, MAJOR LEGAL SYSTEMS IN THE WORLD TODAY 342 (3d ed. 1985). *See also* L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 69-72 (discussing the branch of equity that deals with fiduciary relationships). *See also* DeMott, *supra* note 29, at 880 (noting that "[a]s equity evolved . . . established usages for terms like 'trust' and 'confidence' replaced an earlier and imprecise vocabulary. The term 'fiduciary' itself was adopted to apply to situations falling short of 'trusts' but in which one

stricted rules, developed for itself a flexible, situation-specific jurisprudence. Since issues of fiduciary obligation fell under the jurisdiction of equity rather than law courts, the development and "evolution of fiduciary obligation . . . owe[s] much to the situation-specificity and flexibility that were Equity's hallmarks."[38]

B. The Definition of Fiduciary Obligation

The meaning of the phrase "fiduciary obligation" is so broad, and the circumstances under which such a relation can exist are so varied, that it would be "unwise to attempt the formulation of any comprehensive definition that could be uniformly applied in every case."[39] Its elusive character notwithstanding, some general parameters and familiar core concepts are discernable and firmly entrenched in the definition of "fiduciary obligation." It may be said that a fiduciary relationship exists, giving rise to obligations of that character, where the relationship is confidential. In such confidential relationships equity imposes duties upon the person in whom confidence is reposed in order to prevent the abuse of the confidence.[40] The Restatement of Torts defines a fiduciary relationship as one which "exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation."[41] Black's Law Dictionary provides an equally familiar and traditional definition.[42]

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person was nonetheless obliged to act like a trustee"). *Id.*

38. *Id.* at 881 (observing that "[f]ew areas of the law are as distinctly equitable in character as fiduciary obligation and so few owe so little of their origin or subsequent development to the common law." *Id.* at 882 n.10. For a more general discussion on the subject of how the enforcement of fiduciary duties is traditionally an equitable function, see 1 JOHN N. POMEROY & SPENCER W. SYMONS, A TREATISE ON EQUITY JURISPRUDENCE §§ 151, 157 (5th ed. 1941) and DAN B. DOBBS, REMEDIES § 2.3 (1973).

39. *Warsofsky v. Sherman*, 93 N.E.2d 612, 615 (Mass. 1950). *See generally* Davis, *supra* note 30 (describing the rules that govern the general process of judicial review of fiduciary decision making as a pragmatic accommodation of comparative difficulties with legal relations and private ordering).

40. *See generally* 36A C.J.S. *Fiduciary* 381, 381-89 (1961) (defining fiduciary relationship); JOHN N. POMEROY & SPENCER W. SYMONS, A TREATISE ON EQUITY JURISPRUDENCE § 956a (5th ed. 1941) (noting fiduciary principles); Kurth v. Van Horn, 380 N.W.2d 693, 695-66 (Iowa 1986) (addressing the definition of "fiduciary relation"); *see also* First Bank of Wakeeney v. Moden, 681 P.2d 11, 13 (Kan. 1984) (examining the definition of "fiduciary relation"); Warsofsky v. Sherman, 93 N.E.2d 612, 615 (Mass. 1950) (seeking definition for "fiduciary relationship").

41. RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1979).

42. BLACK'S LAW DICTIONARY defines the fiduciary relation as

> a very broad term embracing both technical fiduciary relations and those informal relations which exist wherever one man trusts in or relies upon another. One founded on trust or confidence reposed by one person in the integrity and fidelity of another. A "fiduciary relation" arises whenever confidence is reposed on one side, and domination and influence result on the other; the relation can be legal, social, domestic, or merely personal. Such relationship exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other.

Consistent with these broad outlines, some of the most oft cited indicia of the existence of a fiduciary relationship include: the acting of one party for another, the dominance or extensive influence of one party over the other, the dependence of one party on the other, inequality of bargaining positions, and the repose of trust and confidence in one party by the other.[43] In a classic and frequently cited definition of fiduciary relation, Lord Chelmsford wrote that such a relation existed:

> [W]henever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed.[44]

Lord Chelmsford's characterization is especially insightful, because it shows that in determining the existence of a breach of trust, the court must examine the particular relationship in question rather than the normal relation of the parties.[45] Invariably, despite the wide breadth encompassed by the nature of a fiduciary obligation, virtually every commentator or court that has had occasion to define its meaning consistently employs such terms as "trust," "confidence," and "influence."[46] It is equally clear from all quarters that courts of equity have declined to narrowly define the specific incidents of fiduciary relations based on a desire to leave the area open for new development.[47] These courts have, however, expressed that such obligations should be imposed whenever "confidence [is] reposed on one side [with] resulting domination and influence on the other.[48] However, while no single and invariable rule has emerged to determine the existence of a fiduciary relationship, most courts which have considered the question have concluded that "it is manifest in all the decisions that there must be not only confidence of one in the other, but there must exist a certain inequality, dependence, weakness of age, of mental strength, business intelligence, knowledge of the facts involved or other conditions giving to one an advantage over the other."[49]

BLACK'S LAW DICTIONARY 564, (5th ed. 1979) (citations omitted).

43. *First Bank of Wakeeney*, 681 P.2d at 13.

44. Tate v. Williamson, 2 Ch. 55, 61 (1866). *See also Warsofsky*, 93 N.E.2d at 615 (quoting *Tate v. Williamson*); M L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 689 (Sup. Ct. 1924) (quoting *Tate v. Williamson*).

45. *M.L. Stewart*, 207 N.Y.S. at 690.

46. *See, e.g.*, Frankel, *supra* note 28, at 829-30 (stating that "[c]ourts regulate fiduciaries by imposing a high standard of morality upon them. This moral theme is an important part of fiduciary law. *Loyalty, fidelity, faith and honor from its basic vocabulary.*") (emphasis added).

47. 36A C.J.S. *Fiduciary*, 381, 385-87.

48. *Id.*

49. *Id.* at 920; Denison State Bank v. Maderia, 640 P.2d 1235, 1241 (Kan. 1982) (quoting Yuster v. Keefe, 90 N.E. 920, 922 (Ind. Ct. App. 1910). *See also* Koening v. Leas, 165

Upon reading this definition, one might be struck by the absence of a reliance requirement. This missing element of reliance is perhaps one of the more interesting and often misunderstood aspects of the fiduciary obligation. Although many cases discuss the question of whether a borrower actually relied on the lender, and, if so, whether such reliance was reasonable under the circumstances, the fiduciary relation does not require reliance, reasonable or otherwise. One scholar expressed this point quite clearly when he wrote, "the law entitles the entrustor to rely on the fiduciary's trustworthiness. The entrustor is therefore not required to show that he actually relied on the fiduciary, and the fiduciary has the burden of justifying self-dealing transactions."[50]

While this result may be counterintuitive at some level, it is, in fact, consistent with the nature and purpose of the fiduciary obligation. As one court noted:

> [t]he heightened duty inherent in a fiduciary relationship justifies imposing liability for breach of that duty regardless of good faith or lack of damage to the beneficiary, because such a standard "is not based on harm done to the beneficiary in the particular case, but rests upon a broad principle of preventing conflict of opposing interests in the minds of fiduciaries, whose duty it is to act solely for the benefit of their beneficiaries."[51]

Such a rule can be quite effective, prophalactically, in preventing a fiduciary from abusing its power, and thus it furthers the equitable goals that underlie the obligation.

C. *The Sources of Fiduciary Obligation*

As a general proposition, the origins of a fiduciary obligation between parties flow from two distinct and independent sources.[52] The first and most traditional source of the fiduciary obligation consists of relationships specifically and expressly created by a contract between the parties.[53] The second and more troublesome source consists of situations where the obligation merely arises out of the relationship between the

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N.E. 2d 134, 137 (Ind. 1960) (quoting same language from *Yuster*). Garrett v. Bankwest, Inc., 459 N.W.2d 833, 838 (S.D. 1990); Mash v. Cutler, 488 N.W.2d 642, 652 (1992) (holding that in order to succeed on a claim for breach of fiduciary duty, the claimant must be "in a position of inequality, dependence, weakness or lack of knowledge") (quoting Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989); Federal Deposit Ins. Corp. v. Fordham, 130 B.R. 632, 648 (Bankr. D. Mass. 1991) (stating that "[a] party owed a fiduciary obligation is often in a position of inequality, inferiority, or other disadvantage).

50. Frankel, *supra* note 28, at 824-25.

51. Federal Sav. & Loan Ins. Corp. v Molinaro, 889 F.2d 899, 904 (9th Cir. 1989) (quoting RESTATEMENT (FIRST) OF RESTITUTION § 197 cmt. c (1937).

52. *See* Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982).

53. *Id.* "Generally, there are two types of fiduciary relationships: (1) those specifically created by contract such as principal and agent . . . and (2) those implied in law due to the factual situation surrounding the involved transactions and the relationship of the parties to each other and to the questioned transaction." *Id.* The analytical focus of this article is on "relational" fiduciary obligations rather than "contractual" ones.

parties.[54]

Typical of contractual fiduciary obligations are those between principal and agent, trustee and cestui que trust, attorney and client, and similar relations.[55] These contractual fiduciary obligations present few problems either for the courts or for scholars.[56] Since the existence of fiduciary obligation is clear in such cases, the only areas of dispute are whether the complained of action constitutes a breach of that duty, and if so what the appropriate measure of damages should be.

Relational or transactional fiduciary obligations are considerably more problematic for both the courts and scholars. The first question in such cases is whether the individual facts and circumstances of the relationship between the parties and the relationship of the parties to the transaction, reasonably gave rise to the existence of a fiduciary obligation.[57] If this question is answered in the negative, the inquiry is necessarily at an end. However, if the answer is affirmative, issues similar to those raised in the contractual context must also be dealt with, i.e. whether the alleged conduct did in fact breach the fiduciary obligation, and, if so, what the proper measure of damages should be. Because the concept of fiduciary obligation is both elusive and equitable by nature, the judicial inquiry is by necessity extremely fact sensitive. Therefore, all such disputes must be resolved on a case-by-case basis.[58]

This distinction between contractual and relational or transactional fiduciary obligations can be somewhat misleading when discussing the lender-borrower relationship. This confusion is caused by the fact that all such relationships are governed for the most part by express contracts. At the very least, each such relationship typically consists of a number of express contracts such as: the commitment letter, the security agreement, a mortgage, and a promissory note, collectively known as "loan documentation." Nowhere in the typical loan documentation is there ever either an express or implied covenant or condition that would, on its own, create a fiduciary relationship between the parties. In fact, often there are express provisions specifically disclaiming fiduciary obligations.[59] However,

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54. *Id. See* Umbaugh Pole Bldg. Co. v. Scottt, 390 N.E.2d 320, 323 (Ohio 1979) ("A fiduciary relationship may be created out of an informal relationship, but this is done only when both parties understand that a special trust or confidence has been reposed."). *See also* Logsdon v. National City Bank, 601 N.E.2d 262, 269 (Ohio C.P. 1991) (stating that "[s]uch a relationship may be specifically created by contract, or it 'may . . . arise out of an informal relationship where both parties to a transaction understand that a special trust or confidence has been reposed.' ") (quoting Blon v. Bank One, 519 N.E.2d 363, 367 (Ohio 1988)).

55. *Denison*, 640 P.2d at 1241.

56. *Id.*

57. *See* Curtis v. Freden, 585 P.2d 993, 998 (Kan. 1978).

58. *Denison*, 640 P.2d at 1241.

59. One notable exception to this general rule is sometimes found in the loan documentation between and among banks that participate in funding a single loan obligation, referred to as "participation agreements." *See, e.g.*, Women's Fed. Sav. & Loan Ass'n v. Nevada Nat'l Bank, 811 F.2d 1255 (9th Cir. 1987). In this case, a participation agreement between the banks specifically provided that Nevada National Bank was to "act as a trustee

it must be remembered that, despite the express language of the parties' contracts, it is their relationship which gives rise to fiduciary duties and claims for a breach of trust.[60] Thus, regardless of the express language found in loan documentation or even the nominal relationship between the parties, it is possible for a fiduciary duty to arise from the conduct of the parties alone, even where none was originally intended.[61]

This is not to say, however, that a fiduciary obligation can be thrust upon a lender without either his express or implied consent. Due to the nature of the obligation, one of its most essential and fundamental sources is the consent of the parties, either express or implied from the surrounding circumstances.[62] In discussing this very issue the court in *M.L. Stewart & Co. v. Marcus*[63] wrote that

> [o]f course no man can obtrude either his trust or his secrets upon another, to the extent of imposing upon the other any obligation in regard thereto, any more than he can render another his bailee in invitum. In that respect banks present a constant invitation to intending borrowers, and thus subject themselves to whatever implication or obligation is to be drawn from that fact.[64]

Similarly, the court in *Pommier v. Peoples Bank Maycrest*,[65] in discussing the domination of one party by another, observed not only that "the essence of a fiduciary relationship is that one party is dominated by

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with fiduciary duties" to protect the interests of Women's Federal Savings and Loan Association. *Id.* at 1258. Despite the apparent clarity of this provision, Nevada National Bank argued that the language was "superfluous, and did not impose any enforceable duties on [it]." The court, however, was unpersuaded and declined to accept Nevada National Bank's "restrictive view" of the loan agreement. *Id.* at 1259. *See also* First Citizens Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co., 919 F.2d 510 (9th Cir. 1990) (holding that loan participation agreement naming bank as trustee did not create a fiduciary duty between bank and other participating institutions); Frankel, *supra* note 28, at 822 (explaining that "explicit contractual waiver provisions do not remove fiduciary relations from the court's supervision, but may merely affect the extent of judicial review over the fiduciary's use of his power").

60. M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 690 (Sup. Ct. 1924).

61. *See, e.g.*, Pommier v. Peoples Bank Marycrest, 967 F.2d 1115 (7th Cir. 1992). "It is possible that the particular circumstances surrounding a relationship will make it a fiduciary relationship, even if the general class of debtor-creditor relationships is not." *Id.* at 1119 (citing Santa Claus Indus. v. First Nat'l Bank, 576 N.E.2d 326, 330 (Ill. Ct. App. 1991); Mid-America Nat'l Bank v. First Sav. & Loan, 515 N.E.2d 176, 180 (Ill. Ct. App. 1987)).

62. *See, e.g., M.L. Stewart*, 207 N.Y.S. at 689, where the court, while describing the nature of the fiduciary obligation, the court stated that "[i]t is, of course clear that a trust or fiduciary relation in its strict sense . . . is created only by mutual consent, express or implied." The court further explained that the one notable exception to this rule is the "constructive trust" which "is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee." *Id.* (quoting Justice Cardozo in Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919)).

63. 207 N.Y.S. 685 (Sup. Ct. 1924).

64. *Id.* at 692.

65. 967 F.2d 1115 (7th Cir. 1922).

the other . . . [but] . . . the dominant party must accept the responsibility, accept the trust of the other party before a court can find a fiduciary relationship."[66] In emphasizing the importance of this acceptance, one scholar noted that generally, courts will only find a fiduciary relationship when both the repose of trust and the invitation or acceptance of such trust are present.[67]

D. The Purpose of the Fiduciary Obligation

Beyond the functions already identified, the fiduciary obligation also serves to reduce the economic costs associated with conducting complex commercial transactions. One prestigious team of scholars has described the process this way: "The fiduciary principle is an alternative to direct monitoring. It replaces prior supervision with deterrence, much as the criminal law uses penalties for bank robbery rather than pat-down

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66. *Id.* at 1119. It is interesting to note that although *M.L. Stewart* was a 1924 New York case and *Pommier* was a 1992 Illinois case, they similarly illustrated a requirement of consent before a fiduciary obligation is imposed. In *M.L. Stewart* the court noted the bank's act of inviting loan customers to do business with it, and thereby inferentially holding itself out to be expert in the field of making loans. The bank was thus responsible for the reasonable inferences to be drawn therefrom. In *Pommier*, the court similarly noted that "[t]he fact that one party trusts the other is insufficient [to establish a fiduciary obligation]." *Pommier*, 967 F.2d at 1119. The court quoted Burdett v. Miller, 957 F.2d 1375 (7th Cir. 1992), for the proposition that "[i]f a person solicits another to trust him in matters in which he represents himself to be expert as well as trustworthy and the other is not expert and accepts the offer and reposes complete trust in him, a fiduciary relation is established." *Pommier*, 967 F.2d at 1119 (quoting *Burdett*, 957 F.2d at 1381). *See* Frankel, *supra* note 28, at 820. Professor Frankel explains that

> [u]nlike status relations, fiduciary relations are not mandated by law. The fiduciary is free to enter or refrain from entering the relation, and cannot be forced to serve without his consent. While the entrustor cannot be forced to enter into the relation, he is not always required to consent to the relation, because he is the beneficiary of the law's protection. Thus, the law is merely permissive with respect to the parties' decision to enter into the relation.
>
> Once a relation is established, however, its classification as fiduciary and its legal consequences are primarily determined by the law rather than the parties. Thus, unlike a party to a contract, a person may find himself in a fiduciary relation without ever having intended to assume fiduciary obligations. The courts will look to whether the arrangement formed by the parties meets the criteria for classification as fiduciary, not whether the parties intended the legal consequences of such a relation. If the criteria are satisfied, the fiduciary will be subject to the duties flowing from that relation, and the entrustor will be entitled to the resulting legal protection.

Id. at 820-21 (footnotes omitted). *See also* Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 23-24 (Colo. Ct. App. 1981) (holding that borrower-lender fiduciary duty may exist when there is trust by the borrower and acceptance by the lender); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619, 623 (Minn. 1972) (holding that when a customer places trust in a bank and relies on it for counsel, special circumstances, which may create a duty, arise if the bank is aware of the trust and reliance); Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1977) (finding a confidential relationship where the lender accepted borrower's trust).

67. Richard B. Hagedorn, *The Impact of Fiduciary Principles on the Bank-Customer Relationship in Washington*, 16 WILLAMETTE L. REV. 803, 806 (1980) (footnote omitted).

searches of everyone entering banks."[68] The fiduciary principle acts as a standard penalty clause in every agency contract, and its flexibility allows it to conform to both the foreseen and unforeseen interests of the parties.[69] In this way, the fiduciary obligation can be accurately characterized as an "off the rack" rule, which the law supplies, but which optimally approximates the bargain that the parties would have made had they been able to (a) bargain without incurring the high costs associated with the time and effort necessarily attendant to the effort, and (b) foresee the many contingencies and possibilities which their relative distribution of power, information, and opportunity might provide.[70]

By reducing the inherently high economic costs of direct monitoring and detailed bargaining, or economizing the transaction costs associated with the relationship, the fiduciary obligation serves a particularly useful function. This is because the vulnerability of the entrustor and the potential for the fiduciary to abuse his power are both quite substantial. However, it is extremely important to note in this regard that the

> entrustor's vulnerability to abuse of power does not result from an initial inequality of bargaining power between the entrustor and the fiduciary. In no sense are fiduciary relations and the risks they create for the entrustor similar to adhesion contracts or unfair bargains. The relation may expose the entrustor to risk even if he is sophisticated, informed, and able to bargain effectively. Rather, the entrustor's vulnerability stems from the structure and nature of the fiduciary relation. The delegated power that enables the fiduciary to benefit the entrustor also enables him to injure the entrustor, because the purpose for which the fiduciary is allowed to use his delegated power is narrower than the purposes for which he is capable of using that power.[71]

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68. Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1981).

69. *Id.*

70. *Id.* Contracts in which parties are incapable of reducing all of the important terms of their relationship to specific and well defined terms have been denoted as "relational contracts." Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1091 (1981). In the context of complex contractual arrangements, the parties are simply unable to anticipate future conditions or adequately gauge them even when the risks are known. *Id.* at 1091. As a result, "it becomes extremely costly—if not literally impossible—for parties constrained by bounded rationality to describe the complete decision tree at the time of bargaining." *Id.* at 1090 n.4 (citation omitted). In response to these conditions of complexity and uncertainty the parties enter into relational contracts, such as fiduciary relations, in an effort to exploit certain economies. *Id.* at 1092. In addition, because the parties have reciprocal needs to economize on transaction costs, they typically select a mix of monitoring and bonding arrangements. *Id.* at 1093. These arrangements assure each party that the other will not take harmful actions, which they would otherwise be contractually free to do. *Id.* at 1093 n.12. Further, such arrangements may be drafted to ensure that if harmful actions are taken the injured party will be compensated. *Id.* (citing Jensen, *supra* note 23, at 308).

71. Frankel, *supra* note 28, at 810. *See, e.g.*, M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685 (Sup. Ct. 1924). The court in this case notes that

> if a person applies for a loan, and in connection with application discloses his purpose to avail of a bargain which he had not as yet closed by contract, and of

II. The Fiduciary Obligation Between Lender and Borrower

The courts are virtually unanimous in holding that the basic relationship between lenders and borrowers is an arm's-length transaction between creditors and debtors.[72] However, they diverge rather sharply regarding the extent to which nominal relationship can or should ever give rise to fiduciary obligations by the lender. In this respect the decisions can be viewed as falling into four distinct categories: (1) a distinct minority of courts have held that fiduciary obligations are fundamentally inconsistent with the very nature of a lender-borrower relationship and thus should never be imposed; (2) a substantial majority have held that fiduciary obligations can arise under "special circumstances" or where there is a "special relationship" between the parties; (3) a small and highly controversial minority of courts have held that the lender-borrower relationship is at least "quasi-fiduciary"; and (4) a small but highly regarded minority of courts have held that there are a number of usual, normal and discrete aspects of the lender-borrower relationship which give rise to fiduciary obligations by their very nature.

A. A Fiduciary Obligation is Inconsistent With the Lender-Borrower Relationship

A great number of courts have been directly presented with the question of whether there are circumstances under which a lender, who is otherwise in an arm's-length relationship with a commercial borrower, may acquire a fiduciary obligation. Only a distinct minority have held that such an obligation is fundamentally inconsistent with the very nature of the lender-borrower relationship. In a relatively recent Georgia case, a bank offered borrowers a lump sum discounted mortgage payoff plan of a loan prepayment.[73] However, the discounts for the mortgage prepayment resulted in a federal tax liability to the borrowers of several million dollars. The borrowers, who were not informed by the bank that such tax consequences were possible, brought suit for five million dollars in actual

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> which the lender had not previously heard, the courts, whether of law or equity, would afford some form of adequate relief in case the applicant was forestalled in his project by the lender.

Id. at 692.

72. *See, e.g.*, Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank, 731 F.2d 112, 122 (2d Cir. 1984) (stating that "[a] correspondent-bank relationship, standing alone, does not create an agency relationship"); Black Canyon Racquetball Club, Inc. v. Idaho First Nat'l Bank, 804 P.2d 900, 905 (Idaho 1991) (affirming the rule that "the relationship in a lender-borrower situation is a debtor-creditor relationship and not a fiduciary relationship"); Blon v. Bank One, 519 N.E.2d 363, 367 (Ohio 1988) (holding that bank/lender did not have a special relationship of trust and confidence and thus had no duty to disclose); Burwell v. South Carolina Nat'l Bank, 340 S.E.2d 786, 790 (S.C. 1986) (holding that status as a depositor during negotiations of loan guarantees was "insufficient to create a fiduciary relationship with the bank").

73. Pardue v. Bankers First Fed. Sav. & Loan Ass'n, 334 S.E.2d 926, 926 (Ga. Ct. App. 1985).

and punitive damages as well as for attorney's fees.[74] The borrowers alleged that in failing to disclose this tax consequence which was known to the bank but not to the borrowers, the bank breached a fiduciary duty to them.[75] The bank prevailed on its motion to dismiss in the trial court and on appeal.[76] In finding for the bank, the trial court held that "[t]he complaint shows no fiduciary duty to disclose a matter that was on public record and equally accessible to plaintiffs and no special relationship existed between the parties other than lender and borrower."[77]

In affirming the trial court's dismissal of the borrower's claim, the court of appeals went even further, stating that

> [w]e agree completely with the trial court, and find no basis whatever to support a fiduciary duty between lender and borrower or bank and customer which would impose a duty upon the bank or savings and loan association to advise appellants concerning their tax status. . . . "There is no confidential [or fiduciary] relationship between a bank and its customers merely because the customer had advised with, relied upon, and trusted the bankers in the past."[78]

In reaching this result, the *Pardue* court made it clear that its holding proceeded from its notion of the very nature of the bank-borrower relationship when they stated, "the lender-borrower relationship is particularly inapposite to a confidential relationship because debtors and creditors have conflicting interests."[79] Notwithstanding a long history of advice given by the bank to the borrowers, and a clear record of trust, confidence, and reliance by the borrowers on the bank, the appellate court was so unmoved that they concluded that "even if the bank had advised the borrowers of tax liability and had misled them, the borrowers would not have been entitled to rely on this advice. Rather, the borrowers would have to conduct their own inquiries into possible tax liability."[80]

The decision in *Pardue* is typical of that minority of cases which hold that, as a matter of principle, the nature of the bank-borrower relationship is such that the imposition of a fiduciary duty is never appropriate. It is especially interesting to note that the *Pardue* court foreclosed such an option, even if the bank had engaged in intentionally misleading conduct that bordered on, if not actually amounted to, fraud; or at the very least, fraud in the inducement. To reiterate this conclusion is based on the court's view of the participants in the bank-borrower relationship as adversaries, across the negotiating table. In such a relationship, a borrower who relies on representations by the bank does so at his peril and may look only to himself and his own paid advisors, e.g. attorneys, ac-

74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.* at 926-27 (quoting Citizens & S. Nat'l Bank v. Arnold, 240 S.E.2d 3, 4 (Ga. 1977)).
79. *Id.* at 927.
80. *Id.* (citing Citizens & S. Nat'l Bank v. Arnold, 240 S.E.2d 3 (Ga. 1977)).

countants and the like, for advice upon which he may justifiably rely.[81]

A similar result occurred at the district court level in the recent case of *Reid v. Key Bank of Southern Maine, Inc.*,[82] where the court held that a confidential or fiduciary relationship between a bank and a borrower "is excluded in principle; to hold otherwise . . . would disrupt a whole system of credit that exists in the economic marketplace in this country."[83] On appeal, although affirming the result, the First Circuit Court of Appeals stated that it had "reservations about the sweeping legal rule announced by the district court."[84] The First Circuit then reviewed cases from other jurisdictions dealing with this issue and found them to be split. A minority firmly stated that no fiduciary relationship existed between a bank and a borrower.[85] Conversely, the majority of jurisdictions held that a fiduciary relationship could "arise when a customer reposes trust in a bank and relies on the bank for financial advice, or in other special circumstances."[86]

Although the *Reid* court observed that there were no Maine cases directly on point, it went so far as to say that "were they presented with the question, [the Maine courts] might agree with the majority view that such relations cannot be excluded *per se* from the context of banks and their depositors or loan customers."[87] Notwithstanding this stated predisposition, the *Reid* court nevertheless held that on the evidence before it, there was insufficient factual particularity regarding the details of the relationship between the lender and the borrower for "an accurate determination of the matter."[88]

Similarly, in another recent case, *Centerre Bank of Kansas City v. Distributors, Inc.*,[89] the Missouri Court of Appeals flatly held that as a matter of law no confidential or fiduciary relationship exists between a bank and its borrowers.[90] This case is particularly noteworthy because the bank involved requested personal guaranties from the borrowing company's principals, as well as from their wives and parents.[91] Three days after receiving the requested personal guaranties, the bank issued the

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81. *See id.* at 927.

82. 821 F.2d 9 (1st Cir. 1987).

83. *Id.* at 16-17 (quoting the district court's unreported opinion).

84. *Id.* at 17.

85. *Id.* (citing Centerre Bank v. Distributors, Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985)).

86. *Id.* (quoting Baylor v. Jordan, 445 So. 2d 254, 256 (Ala. 1984)).

87. *Id.*

88. *Id.* (citation omitted). The only evidence that the borrower offered for proof of a confidential relationship was the high quality of the working relationship between himself and the bank loan officer. However, the only advice which the bank officer had offered the borrower was to recommend a particular supplier and a particular accountant. *Id.* On the basis of these facts, the court found that the evidence was very "vague" with respect to any faith, trust, or reliance reposed in the bank by the borrower. *Id.* at 17-18.

89. 703 S.W.2d 42 (Mo. Ct. App. 1985).

90. *Id.* at 53 (citing Delta Diversified, Inc. v. Citizens & S. Nat'l Bank, 320 S.E.2d 767, 776 (Ga. Ct. App. 1984)).

91. *Id.* at 45.

company a sixty-day demand notice of the loan.[92] The guarantors claimed the existence and breach of a fiduciary obligation because, by the bank's own admission, at the time the bank requested the personal guaranties it did not consider the loan to be a "good loan" and had in fact made an internal classification of the loan on their "problem loan list."[93] None of this information was disclosed to the guarantors.[94] Moreover, despite this internal bank classification, the bank had assured the company's principals that, if the guaranties were provided, the loan would be continued. Notwithstanding these facts, the court held that the guarantors could not avoid their liabilities on such guaranties because the bank was under no "legal or equitable obligation to communicate"[95] the withheld information to them, nor were they entitled to any such communication. This case, along with the *Pardue* and *Reid* cases, is typical of those cases which flatly deny the possibility of a fiduciary relationship in the borrower-lender context.

B. A Fiduciary Obligation Between Lenders and Borrowers Can Arise Under Special Circumstances or Where a Special Relationship Exists

Courts are often reluctant to find a fiduciary relationship running from a lender to its borrower, due to the fundamental view that the normal lending relationship is a product of arms-length bargaining.[96] To require a lender to act as a fiduciary in such a situation would be anomolous, since it would then be required to protect the interests of an adverse party in the bargaining process.[97] Generally, the lender-borrower relationship is simply that of debtor and creditor, which does not give rise to fiduciary obligations.[98] However, under certain circumstances and in special situations, this general rule is significantly altered.[99] The Washington Court of Appeals described this relationship with clarity in the case of *Tokarz v. Frontier Federal Savings & Loan Ass'n*:[100]

> As a general rule, the relationship between a bank and a depositor or customer does not ordinarily impose a fiduciary duty of disclosure upon

92. *Id.*

93. *Id.* This indicated that the bank considered the loan to be a high risk of loss.

94. *See id.*

95. *See id.* at 53.

96. Weinberger v. Kendrick, 698 F.2d 61, 79 (2d Cir. 1982), *cert. denied*, 464 U.S. 818 (1983). *See also* Umbaugh Pole Bldg. Co. v. Scott, 390 N.E.2d 320, 323 (Ohio 1979) (finding that although advice was given by the lender in a sincere effort to help the borrower, the fact that the lender was an institution and the transaction was commercial put the parties at arm's length despite appearances). While not foreclosing the possibility of a fiduciary obligation created by an informal relationship, the *Umbaugh* court concluded that "this is done only when both parties understand that a special trust or confidence has been reposed." *Id. See also* Snow v. Merchants Nat'l Bank, 35 N.E.2d 213, 217 (Mass. 1941) (discussing the creation of fiduciary relationships in commercial settings).

97. *Weinberger*, 698 F.2d at 79.

98. *See* Deist v. Wachholz, 678 P.2d 188 (Mont. 1984).

99. *See id.*

100. 656 P.2d 1089 (Wash. Ct. App. 1983).

> the bank. They deal at arm's-length. However, "special circumstances" may dictate otherwise: one who speaks must say enough to prevent his words from misleading the other party; one who has special knowledge of material facts to which the other party does not have access may have a duty to disclose these facts to the other party; and one who stands in a confidential or fiduciary relation to the other party to a transaction must disclose other facts. Present-day commercial transactions are not, as in past generations, primarily for cash; rather modern banking practices involve a highly complicated structure of credit and other complexities which often thrust a bank into the role of an advisor, thereby creating a relationship of trust and confidence which may result in a fiduciary duty upon the bank to disclose facts when dealing with the customer.[101]

Of course, the Washington Court of Appeals was not the first court to consider this issue and to hold that where there was evidence of a special relationship or circumstance, a bank's otherwise arm's-length relationship to its customers could become fiduciary in nature. As far back as 1937, the Arizona Supreme Court, in *Stewart v. Phoenix National Bank*[102] had reached the same conclusion.[103]

Beyond the particular facts of the individual case, courts which have considered the question of whether a special relationship or special circumstances exist between a lender and a borrower have given little express prospective guidance regarding the elemental constituents of such relationships or circumstances. Any insight into the elements of these relationships and circumstances must therefore be a product of reviewing, distilling and marshaling the common ground found in each of the major cases. A careful review of the cases in this area reveals that they share some common thoughts regarding what constitutes a "special relationship" or a "special circumstance." These common thoughts are based upon the following three categories of factors: (a) the borrower reposing special trust and/or confidence in the lender;[104] (b) the borrower receiving

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101. *Id.* at 1092 (citing Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937)); Richfield Bank & Trust v. Sjogren, 244 N.W.2d 648 (Minn. 1976); Klein v. First Edina Nat'l Bank, 196 N.W.2d 619 (Minn. 1972); Pigg v. Robertson, 1549 S.W. 597, 600 (Mo. Ct. App. 1977).

102. 64 P.2d 101 (Ariz. 1937).

103. *Id.* at 106. Although the court in *M.L. Stewart* framed its analysis in terms of a "confidential relationship" and "confidential relations," it is important to note that, for the most part, the overwhelming majority of cases in this area consider the terms "confidential" and "fiduciary" to be synonymous and interchangeable. *See, e.g.*, Reid v. Key Bank of S. Maine, Inc., 821 F.2d 9, 16 n.4 (1st Cir. 1987) (stating that "[i]n Maine, 'fiduciary' and 'confidential relations' are legal equivalents"); Barrett Bank v. Bank of Am., 229 Cal. Rptr. 16, 20 (Ct. App. 1986) (stating that "[c]onfidential and fiduciary relations are, in law, synonymous"). *See also* Fridenmaker v. Valley Nat'l Bank, 534 P.2d 1064 (Ariz. Ct. App. 1975) (agreeing with *M.L. Stewart* rule); Bank of Am. v. Sanchez, 38 P.2d 787, 789 (Cal. Ct. App. 1934) (noting that fiduciary relations are not limited to legal relations, but "may be moral, social, domestic, or merely personal").

104. For a discussion of special circumstances on which the borrower resposes trust or confidence in the lender, see *infra* notes 106-154 and accompanying text.

and relying on advice rendered by the lender;[105] and (c) the lender gaining superiority, influence, dominion or control over the borrower.[106] These categories are rarely sharply defined, and cases often mix and mingle them in a variety of combinations and permutations. Additionally, courts often require that the lender have knowledge of one of the factors, either expressly or by reason of the circumstances, and have accepted it.

1. Reposing special trust or confidence in the Lender

In the absence of bargained-for fiduciary relations, the courts look at surrounding circumstances to determine whether a special relation exists between the borrower and the lender. When the borrower reposes trust or confidence in the lender, many courts will find that the lender owed the borrower a fiduciary duty. Courts are more likely to find a fiduciary duty if the bank knew or had reason to know that the borrower had reposed trust and confidence in the bank. The following cases illustrate the court's willingness to examine the circumstances surrounding a lender-borrower relationship with an emphasis on the trust and confidence of the borrower and the knowledge and conduct of the owner. In *Barnett Bank v. Hooper*,[107] the Supreme Court of Florida held that a bank officer's confirmation of the soundness of the borrower's proposed investment coupled with the borrower's long-standing relationship with the bank, was sufficient to create a confidential relationship.[108] The court held that a bank may have a duty to disclose material facts to a customer with whom it has established a relationship of trust and confidence, where it has special knowledge that may be critical to the customer.[109]

In *Barnett Bank*, the bank's customer had been engaged in business with the bank since 1973.[110] In 1981 the customer met with a tax shelter adviser named Hosner, who arranged a meeting between the customer and the bank.[111] At that meeting, the bank confirmed that it was familiar with Hosner and his business and the loan officer in charge of Hosner's accounts affirmed the viability of the business.[112] The officer further informed the customer that Hosner Enterprises was sound and had passed IRS scrutiny.[113] The customer then borrowed $50,000 from the bank and invested it with Hosner.[114]

A few months following this initial investment, the bank began to

105. For a discussion of special circumstances involving the borrower's reliance on advice received from the lender, see *infra* notes 155-184 and accompanying text.

106. For a discussion of special circumstances involving the lender's acquisition of superiority, influence, dominion, or control over the borrower, see *infra* notes 185-194 and accompanying text.

107. 498 So.2d 923 (Fla. 1986).

108. *Id.* at 925.

109. *Id.*

110. *Id.* at 924.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

suspect that Hosner was involved in a check-kiting scheme and began an internal investigation of his operations.[115] Within a short time the situation had deteriorated to a point where the bank felt it was at risk, and it thus decided to return all of Hosner's checks unless drawn against good and collected funds.[116]

A short time later, the customer called Hosner who brought the bank officer into the phone conversation.[117] During that conversation, the customer asked to borrow an additional $90,000 from the bank.[118] The bank correctly assumed that this loan was going to be used to fund a further investment with Hosner, and on that basis approved and processed the loan.[119] The bank then received its own loan proceeds check from Hosner, which had been made payable to the bank's customer but was then signed over to Hosner Enterprises and deposited into that company's checking account.[120] The check-kiting scheme was confirmed a short time later, and because of the customer's deposit with Hosner Enterprises, the bank was able to avoid an $87,000 loss.[121]

The customer never realized any return on his investment with either Hosner or Hosner Enterprises and subsequently brought suit against the bank alleging among other things, a breach of fiduciary duty.[122] The court found the bank liable on this theory and noted that a fiduciary relationship will arise from special circumstances

> where a bank, having actual knowledge of fraud being perpetrated upon a customer, enters into a transaction with that customer in furtherance of the fraud, or where a bank has established a confidential or fiduciary relationship with a customer . . . . Accordingly, we find that where a bank becomes involved in a transaction with a customer with whom it has established a relationship of trust and confidence, and it is a transaction from which the bank is likely to benefit at the customers expense, the bank may be found to have assumed a duty to disclose facts material to the transaction, peculiarly within its knowledge, and not otherwise available to the customer.[123]

Similarly, in *Central State Stamping Co. v. Terminal Equipment Co.*,[124] a prospective purchaser of machinery from Terminal Equipment Company called Terminal's bank to verify the company's financial condition.[125] The bank indicated that Terminal was undercapitalized but failed to disclose its prior default on two separate loans from the bank.[126] Cen-

115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.* at 925 (citations omitted).
124. 727 F.2d 1405 (6th Cir. 1984).
125. *Id.* at 1406-07.
126. *Id.* at 1408.

tral State subsequently made a down payment on the machinery which was utilized by Terminal to reduce its debt to the bank.[127] Terminal subsequently filed bankruptcy and failed to deliver the machines to Central State.[128] At trial the court held that once the bank officer voluntarily undertook to provide information to the purchaser concerning Terminal's creditworthiness, he had a duty to disclose the facts concerning its financial instability.[129]

The process of examining the circumstances of trust and confidence is again well illustrated in the case of *Klein v. First Edina National Bank*.[130] In that case the plaintiff was the customer of a bank who was employed by another customer of the same bank.[131] The plaintiff's employer applied for a loan from the bank, which was granted, in part because the plaintiff pledged stock which she owned in her own name, on behalf of her employer.[132]

The bank did not inform the plaintiff of the circumstances surrounding the loan, including the employer's loan history.[133] Ultimately the employer defaulted on the loan and the plaintiff lost the stock which she had pledged as collateral.[134] She argued at trial that the bank owed her a fiduciary duty, which it breached by failing to disclose the purpose of the loan as well as other relevant and important background circumstances.[135] The court rejected the plaintiff's argument and held that

> [w]hen the bank transacts business with a depositor or other customer, it has no special duty to counsel the customer and inform him of every material fact relating to the transaction—including the bank's motive, if material, for participating in the transaction—unless special circumstances exist, such as where the bank knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank so to counsel and inform him.[136]

Another important case illustrating the special relationship involved in fiduciary relationships is *High v. McLean Financial Corp.*[137] In *High*, the court explained that "fiduciary relationship" is loosely defined "so that the relationship may change to fit new circumstances in which a special relationship of trust may be properly implied.[138] In analyzing the case before it, the *High* court was true to District of Columbia law which traditionally looked for close relationships which transcend an ordinary business relationship and demand that the parties to the relationship protect

127. *Id.*
128. *Id.*
129. *Id.* at 1409.
130. 196 N.W.2d 619 (Minn. 1972).
131. *Id.* at 621.
132. *Id.*
133. *Id.*
134. *Id.* at 621-22.
135. *Id.* at 622-23.
136. *Id.* at 623.
137. 659 F. Supp. 1561 (D.D.C. 1987) (citation omitted).
138. *Id.* at 1568 (citation omitted).

one another.[139]

In *High*, the plaintiffs alleged that a fiduciary duty existed between themselves as loan applicants and the bank simply by virtue of "their loan application, processing fees, and defendants' promises to plaintiffs."[140] Accordingly, they claimed that the bank owed them a duty to process their loan application promptly, accurately inform them of its status, inform them if the decision was to be made by others, and advise them of any difficulties.[141] The court stated that the plaintiff's complaint sufficiently supported an inference of a fiduciary duty and breach thereof, thus holding that a fiduciary duty could arise between a loan applicant and a bank.[142] It was declared to be a legally cognizable claim and could not be decided as a matter of law, but rather needed to be resolved on the basis of a full hearing on the facts of the case. Although the court in *High* did not go into detail regarding what would constitute the "appropriate circumstances" necessary to establish a fiduciary relationship, it did conclude that it was "not convinced . . . that a fiduciary duty can never exist between a lender and a loan applicant."[143]

A number of state courts have also held that a lender owes a fiduciary duty to its borrower due to a perceived relationship of trust and confidence between them. In such circumstance, the perceptions of the entrustor are the focus of the courts' deliberations. The oft-quoted case of *Barrett v. Bank of America*,[144] dealing with a claim of constructive fraud, demonstrates this focus. In *Barrett*, the plaintiffs executed personal guaranties, secured by deeds of trust on parcels of real estate, to support a loan by the defendant bank to a corporation in which the plaintiffs were the principal shareholders.[145] Within a month after the loan was made, the bank determined that the company was in technical default of the loan agreement.[146] The bank's loan officer discussed with the borrower various methods of improving the company's financial situation. Among these proposals was a merger whereby the resulting company would be responsible for the debt and the plaintiffs would be released from their guaranties and liability.[147] Subsequently, following the bank's advice, such a merger did in fact take place, the terms of which provided that the plaintiffs were to be released from the prior guaranties after a period of six months.[148] However, soon thereafter, the new company filed for bankruptcy protection under chapter 11 and foreclosure proceedings were instituted against the plaintiffs on their guaranties.[149] The plaintiffs,

139. *Id.* (citations omitted).
140. *Id.* at 1568.
141. *Id.*
142. *Id.* at 1568-69.
143. *Id.* (citation omitted).
144. 229 Cal. Rptr. 16 (Ct. App. 1987).
145. *Id.* at 17.
146. *Id.* at 17-18.
147. *Id.* at 18.
148. *Id.*
149. *Id.*

alleging that the bank's loan officer had promised that they would be released from these underlying guaranties if the merger was consummated, brought suit against the bank for damages for breach of contract, fraud, constructive fraud, conspiracy to defraud, negligence, and intentional infliction of emotional distress.[150]

The issue of liability was then submitted to the jury in a special verdict form. The plaintiffs requested a special instruction on "constructive fraud," but their request was denied by the court.[151] In the special verdict, the jury found that (1) the bank's employee had made the alleged promise to release them from their personal guaranties if the merger was conducted as specified, and (2) that the plaintiffs had reasonably relied on such promise.[152] However, the jury also concluded that notwithstanding the foregoing, there was no intent to defraud.[153] The trial judge there upon entered a verdict for the bank.

On appeal, the California Court of Appeals held that the trial judge erred in failing to give the requested special instruction on "constructive fraud." In so finding the court said:

> Constructive fraud exists in cases in which conduct, although not actually fraudulent, ought to be so treated—that is, in which such conduct is a constructive or quasi fraud, having all the actual consequences and all the legal effects of actual fraud. Constructive fraud usually arises from a breach of duty where a relation of trust and confidence exists. Confidential and fiduciary relations are in law, synonymous and may be said to exist whenever trust and confidence is reposed by one person in another. The relationship of a bank to depositor is at least quasi-fiduciary.[154]

The *Barrett* court found "substantial evidence" supporting the plaintiffs' theory of constructive fraud and a fiduciary relationship, such as, (1) the plaintiffs' perception of a close relationship to the loan officer, (2) the plaintiffs' implicit reliance on the bank's advice concerning the merger, (3) the plaintiffs' sharing of confidential financial information with the bank, and (4) the fact that the bank "stood to benefit from the merger."[155] Taken together, the cases discussed in this section illustrate the willingness of courts to look to the surrounding circumstances of a bank's conduct with a particular emphasis on the relationship involved in an effort to determine whether there was the repose of trust and confidence in the bank and whether the bank was aware of such repose and accepted it. When there is such a repose of trust and confidence in the lender who then knowingly and willingly accepts it, a relational predicate is established, giving rise to a fiduciary duty on the part of the bank which otherwise would not have existed.

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150. *Id.*
151. *Id.*
152. *Id.* at 19.
153. *Id.*
154. *Id.* at 20 (citations omitted).
155. *Id.* at 20-21.

2. Advice and reliance

The second factor which plays an active role in the formation of a fiduciary relationship is the advice often given by lenders and the relative reliance placed on that advice by borrowers. In a recent Alabama case, one of two partners in a long-standing furniture business sought financing on his own behalf from the company's bank, in order to fund the buy out of his partner's interest in the business.[156] When the departing partner learned of their bank's involvement he brought suit and urged the court to recognize a fiduciary relationship between himself and the bank.[157] The court rejected the request, holding that although "[a] fiduciary duty may arise when the customer reposes trust in a bank and relies on the bank for financial advice, or in other special circumstances"[158] there were no allegations in the present case that the plaintiff had either placed trust and confidence in the bank or that he had relied on the bank officer to counsel him.[159]

In the case of *Stewart v. Phoenix National Bank*,[160] the court found that because of a twenty-three-year-old relationship between the lender and the borrower, the borrower was justified in believing that when the bank undertook to advise him it would not take financial advantage of him.[161] The bank, however, not only gave the borrower bad advice, but actually affirmatively misled him. The court held that the allegation that the bank had served as the borrower's financial advisor for many years, with corresponding customer reliance, was sufficient to sustain the borrower's claim that a fiduciary duty existed.[162] The court failed, however, to explain at what point the relationship was actually established.

The Illinois Court of Appeals recently faced the issue of the establishment of fiduciary obligations in the case of *Mid-America National*

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156. Baylor v. Jordan, 445 So. 2d 254, 255 (Ala. 1984).

157. *Id.* at 256.

158. *Id.*

159. *Id.* The court impliedly offered some additional guidance regarding what factors might constitute a "special relationship or circumstances," stating

> [n]or do we opine that other special circumstances exist here which would warrant a fiduciary duty on the part of the bank to disclose. This is not a situation where a party with superior knowledge acted to the detriment of a party in an inferior position. There was no weakness of age, no lack of mental strength and no absence of business intelligence.

Id.

160. 64 P.2d 101 (Ariz. 1937).

161. *Id.* at 106.

162. *Id. But see* Pieper v. Melrose Credit Union, No. C7-92-2474, 1993 Minn. App. LEXIS 85, at *4 (Jan. 26, 1993) (rejecting a claim of reliance based upon a long-term borrower-lender relationship and holding that although the borrower "stated by affidavit that he relied on the credit union's advice, there is no claim that the credit union knew or had reason to know of any special reliance nor factual support for the claim, if made"). *See also* Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1977) (ruling in favor of the borrower based on a finding that the bank knew that it was being called upon to provide advice and therefore, "could reasonably be expected to know that such reliance was placed in [it]"). *Id.* at 601.

Bank v. First Savings & Loan Association.[163] Although finding that no fiduciary relation existed in the case before it, the court concluded that even in cases where no fiduciary duty was established by strict legal principles, close relationships where one party places great reliance on the other could give rise to a fiduciary relationship.[164] In *Mid-America*, the borrower brought suit against his mortgage lenders, alleging that they had breached a duty owed to him because they lent him mortgage funds without informing him that the properties he planned to acquire were located in a flood hazard area and that there was flood insurance available through the lender.[165] Although the borrower did in fact suffer an uninsured flood loss on the acquired properties, he was unable to demonstrate, notwithstanding his long relationship with the bank, that there was any attempt on its part to advise him regarding the flood status of the property, and thus he could prove no reliance on his part.[166] The court held that the bank's silence did not give rise to the type of special circumstances required to create a fiduciary duty.[167]

In other contexts, however, silence on the part of a lender and a borrower's corresponding reliance on that silence has been held to satisfy the special circumstances requirement. In *First National Bank v. Brown*,[168] the bank made a loan to the borrower knowing that the proceeds were going to be used to purchase an interest in property in which the bank had a substantial lien interest.[169] At no time during the negotiation or consummation of the loan did the bank mention to the borrower its lien interest in the property.[170] Additionally, the bank did not inform the borrower that once his loan was funded and he purchased the encumbered property, it was the bank's intention to apply a substantial portion of it in satisfaction of its preexisting lien.[171] When the bank did so, the borrower brought suit claiming a breach of fiduciary obligation.[172]

In ruling against the bank, the court stated first the basic principle that "[o]rdinarily mere silence on the part of one party in an arms-length transaction, as to material facts discoverable by the other does not serve to create actionable fraud."[173] The court next explained, however, that where there exists a relationship of trust or confidence, and the trusted party has superior knowledge of the facts . . . [t]he superior party has a duty to disclose all material facts of which he is aware."[174] The court found that due to the bank officer's behavior and the actions of the bor-

163. 515 N.E.2d 176 (Ill. Ct. App. 1987).
164. *Id.* at 180 (citation omitted).
165. *Id.* at 177-78.
166. *Id.* at 180-81.
167. *Id.* at 181.
168. 181 N.W.2d 178 (Iowa 1970).
169. *Id.* at 180.
170. *Id.*
171. *Id.* at 181.
172. *Id.*
173. *Id.* at 182.
174. *Id.* (citations omitted).

rower, it was clear that the officer either knew or should have known of the reliance placed on his trustworthiness.[175] Thus, the court concluded that "there was imposed upon [the bank] an unfulfilled duty of disclosure."[176]

In stark contrast to the holding and reasoning in *Brown*, the court in the case of *Denison State Bank v. Madeira*,[177] rejected the silence-as-breach theory under very similar facts. In that case, just as in *Brown*, the undisclosed facts were a matter of public record and were not disclosed by the lender.[178] When the borrower's fortunes changed for the worse, he brought suit claiming that the bank owed him a fiduciary duty to disclose negative information within its knowledge prior to making the loan.[179] The court reasoned that, "[t]he facts which the defendant [borrower] contends were concealed from him were either a matter of public record or were otherwise readily available if some reasonable effort had been made to ascertain them."[180] It then concluded that the borrower must be responsible for using some diligence to protect himself and could not rely on the bank to provide information in the public record.[181] The *Denison* court was unsympathetic to fiduciary notions and adhered to the traditional adversarial rule for parties to a transaction, noting that the borrower was an experienced businessperson who was "fully competent and able to protect his own interests."[182] Not doubting the borrower's testimony that he had in fact trusted and relied upon the bank, the court rather regarded that reliance as unreasonable under the circumstances, presumably because of his experience and sophistication.[183] In so ruling, the court said that as a matter of policy "one may not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on another without a conscious assumption of such duties by the one sought to be held liable as a fiduciary."[184] The court explained that the adoption of such a standard would put an intolerable obligation upon banking institutions and convert ordinary day-to-day business transactions into fiduciary relationships where none were intended or anticipated."[185]

That *Denison*, despite its factual similarity to *Brown*, resulted in a contrary holding, demonstrates that the element of reliance as an indicia of a "special circumstance" may in some way interrelate with the third

175. *Id.* "[T]he record clearly discloses [that the bank's lending officer] so comported himself that he knew or should have known from the [borrower's] questions and reaction that the latter trusted him implicitly," and was therefore relying on his trustworthiness.

176. *Id.*

177. 640 P.2d 1235 (Kan. 1982).

178. *Id.* at 1239.

179. *Id.*

180. *Id.* at 1243.

181. *Id.*

182. *Id.* at 1244.

183. *Id.* at 1243.

184. *Id.* at 1243-44.

185. *Id.* at 1243.

theory under which courts have found that a fiduciary relationship between a borrower and lender may be established—superiority, influence, dominion, or control of one party over the other.

3. Superiority, influence, dominion or control

The cases in this category are generally consistent with the principle that when a borrower reposes faith and confidence in her lender it is possible for the normal arm's-length transaction to evolve into one which places fiduciary duties on the lender. However, the following cases take that standard further and require that two additional conditions be met. Not only must the borrower repose such faith and confidence in the lender but in addition: (1) as a direct and causal consequence, the lender must thereby acquire dominion, control or influence over the affairs of the borrower, and (2) the borrower must also be in a position of weakness, dependence or inequality.

In one such case, *Garrett v. Bank West, Inc.*,[186] the borrower was a farmer attempting to expand operations to increase production and profitability.[187] Garrett, the farmer/borrower, had acquired a loan with a bank with which he had an ongoing relationship in order to finance the expansion.[188] When the borrower encountered financial difficulties in making loan payments, the bank proposed a schedule of cash flows and a total payment scheme.[189] The borrower's finances continued their spiral descent, however, unaided by the bank's suggestions. Ultimately, the farm was lost.[190] Garrett claimed that he and the bank were involved in a fiduciary relationship.[191] The principal consideration of the court in determining the existence of such a relationship was not the "mere rendering of advice,"[192] but whether the lender had exerted any control over a weak and dependent borrower.[193] The court explained that while a relationship between a bank and borrower is generally seen as a debtor-creditor relationship involving no fiduciary duties, "[s]uch a relationship can become a fiduciary relationship if the borrower reposes a faith, confidence, and trust in the bank which results in dominion, control or influence over the borrower's affairs. . . [but] the borrower who reposes the confidence must be in a position of 'inequality, dependence, weakness or lack of knowledge.' "[194] The court in *Garrett* had no doubt that advice had been rendered and relied upon, but because the borrower was knowledgeable, and because the lender had not taken decisional or physical control of opera-

186. 459 N.W.2d 833 (S.D. 1990).
187. *Id.* at 835.
188. *Id.* at 836.
189. *Id.*
190. *Id.*
191. *Id.* at 837.
192. *Id.* at 838.
193. *Id.* at 838-39.
194. *Id.* at 838 (quoting Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989)).

tions, no fiduciary relationship could be established.[195]

C. *The Lender-Borrower Relationship as Quasi-Fiduciary*

1. *The Rise of* Commercial Cotton

In 1985 the California Court of Appeals upheld the claims of a commercial depositor against a bank in *Commercial Cotton Co. v. United California Bank*,[196] and in so doing advanced a highly controversial and innovative theory. Analogizing the relationship between a bank and its depositor with that which exists between an insurer and its insured, the court held that "[t]he relationship of bank to depositor is at least quasi-fiduciary."[197] In *Commercial Cotton*, the plaintiff was not a commercial borrower, but rather a commercial enterprise that maintained an ordinary checking account with the defendant bank. Upon discovering the loss of a number of blank checks imprinted with the bank's name and the plaintiff company's name and account number, the company reported the loss to the bank.[198] Some time later when one of the lost checks in the amount of $4,000 was presented to the bank with a forged signature, the bank honored the check despite its prior notice from the company.[199]
When the plaintiff discovered the loss and made a demand on the bank for repayment, the bank denied liability and refused to repay the depositor for the wrongfully paid check.[200] In its defense, the bank weakly argued that the depositor had failed to bring its claim before the expiration of a one-year statute of limitations and was guilty of comparative negligence in losing the checks in the first place.[201] In finding for the plaintiff, the court held that, due to a "quasi-fiduciary duty" of a bank to its depositor, depositors have a right to "reasonably expect a bank not to claim nonexistent legal defenses to avoid reimbursement when the bank negligently disburses entrusted funds."[202] The bank's defense on the basis of the expiration of a one-year statute of limitations was held to be "spurious . . . and the jury found experienced legal counsel interposing them in an unjustifiable, stonewalling effort to prevent an innocent depositor from recovering money entrusted to and lost through the bank's own negligence."[203]

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195. *Id.* at 838-39. Similarly, in Paskas v. Illinois Fed. Sav. & Loan Ass'n, 440 N.E.2d 194 (Ill. Ct. App. 1982), the court found that although there was a reposing of faith and confidence in the bank, "to the extent that anyone reposes trust and confidence in a commercial bank, there was no resulting superiority and influence on [the bank's] part so as to create a fiduciary relationship." *See also* Evra Corp. v. Swiss Bank Corp., 522 F. Supp. 820, 829 (N.D. Ill. 1981) (requiring a showing of superiority and influence to establish a fiduciary relationship between borrower and lender).

196. 209 Cal. Rptr. 551 (Ct. App. 1985).

197. *Id.* at 554.

198. *Id.* at 553.

199. *Id.*

200. *Id.*

201. *Id.* at 553-54.

202. *Id.* at 554.

203. *Id.* The court's conclusion that the bank's defense was spurious was based in

The essence of the plaintiff's claim in *Commercial Cotton* was that the bank's actions constituted a breach of the covenant of good faith and fair dealing which is implied in every contract.[204] On this basis the company sued the bank and received a judgment for $4,000 in compensatory damages and $100,000 in punitive damages.[205] Because punitive damages cannot be awarded in an action based only on simple breach of contract,[206] on appeal the validity of the punitive damage award turned on the extent to which the underlying cause of action for breach of the covenant of good faith stated a cause of action sounding in tort or contract.[207]

In finding for the plaintiff, the court held that their action sounded in tort by virtue of a tortious breach of the implied contractual obligation of good faith and fair dealing.[208] This decision was premised on two theories: (1) the existence of a special relationship between the bank and its depositor, and (2) the newly enunciated tort of bad faith defense.[209] The "special relationship" theory was derived from a then-recent California case which considered the question of a "special relationship" in the context of an insurance contract and had held that this relationship is "characterized by elements of public interest, adhesion, and fiduciary responsibility."[210] In addition, the *Commercial Cotton* court went on to

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large part on the fact that almost two weeks prior to its general counsel sending the plaintiff a final letter refusing reimbursement, the California Supreme Court had ruled specifically that a three-year statute of limitations, rather than the claimed one-year statute was applicable to claims such as the one being made by this depositor. *Id.* at 553 (citing Sun 'n Sand, Inc. v. United California Bank, 582 P.2d 920 (Cal. 1978)).

204. "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979). The claim of a breach of the duty of good faith has been a major source of lender liability litigation. However, as the term "good faith" is still shrouded in mist and is difficult to define directly, it has been held that, in essence, it is an "excluder" which is "without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith. In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out." Foley v. Interactive Data Corp., 765 P.2d 373, 399 (Cal. 1988) (quoting Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201 (1968)).

205. *Commercial Cotton*, 209 Cal. Rptr. at 552.

206. *See* CAL. CIV. CODE § 3294(a) (Deering 1984) (providing that punitive damages may be awarded only in "an action for the breach of an obligation not arising from contract").

207. *Commercial Cotton*, 209 Cal. Rptr. at 554.

208. *Id.*

209. *Id.*

210. *Id.* (citing Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141 (Cal. 1979)). *Egan* involved the imposition of tort liability in what ostensibly appeared to be the contractual context of an insurance agreement. In explaining its rationale for the imposition of tort liability in that context, the *Egan* court emphasized the nonprofit objectives of the insured in seeking protection and peace of mind and the quasi-public and vital nature of the services provided by insurance companies and concluded that the insurance relationship had a fiduciary quality. *Egan*, 620 P.2d at 146. For a discussion of commercial bad faith, see C. Delos Putz, Jr. & Nona Klippen, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy for Stonewalling*, 21 U.S.F. L. REV. 419, (1987). *See also* Careau & Co. v. Security Pac. Business Credit, Inc., 272 Cal. Rptr. 387 (Ct. App. 1990). The tort of breach of

note that in another case the California Supreme Court had "found it unnecessary to determine how far, if at all, the doctrine should extend to ordinary commercial contracts where parties of 'roughly equal bargaining power are free to shape the contours of their agreement.' "[211] Moreover the California Supreme Court had suggested in dictum that this form of tort recovery might be appropriate wherever there are, "relationships

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the implied covenant of good faith had its origins in the insurance context in Crisci v. Security Ins. Co., 426 P.2d 173 (Cal. 1967).

211. *Commercial Cotton*, 209 Cal. Rptr. at 554 (citing Seaman's Direct Buying Serv., Inc. v. Standard Oil Co. of California, Inc., 686 P.2d 1158, 1167 (Cal. 1984). The court in *Seaman's* also stated that "[n]o doubt there are other relationships with similar characteristics and deserving of similar legal treatment." *Seaman's*, 686 P.2d at 1166. However, the court then cautioned that any consideration of this tort remedy in the "ordinary" commercial context was a move "into largely uncharted and potentially dangerous waters." *Id.* at 1166-67. It then concluded by noting that, "[t]his is not to say that tort remedies have no place in such a commercial context." *Id.* at 1167. This discussion by the *Seaman's* court was dictum, however, because the court found it unnecessary to predicate liability in that case on the breach of the implied covenant. Instead, it identified the new tort of intentional and bad faith denial of the existence of a contract, and rested its decision upon those shores. *Id.* Despite being dictum, the language of *Seaman's* generated a good deal of interest and comment. One scholar wrote that

> [o]nce the concept of good faith and fair dealing was found to be a part of the insurance contract, it did not take long until attorneys were asserting that such a covenant must also logically be a part of other types of contracts. Following what appeared to be the obvious lead of the California Supreme Court, lower courts began extending the concept of good faith to other types of contracts.

Eric Wright, *Introduction to Symposium, Bad Faith and Punitive Damages*, 29 SANTA CLARA L. REV. 546 (1989). Additionally, one federal circuit court noted in a particularly memorable and scathing analysis of the decision in *Seaman's* that "[i]n inventing the tort of bad faith denial of a contract [in *Seaman's*] the California Supreme Court has created a cause of action so nebulous in outline and so unpredictable in application that it more resembles a brick thrown from a third story window than a rule of law." Oki Am., Inc., v. Microtech Int'l, Inc., 872 F.2d 312, 315 (9th Cir. 1989). However, dispite the ominous rumblings in *Oki*, most courts did not rush to expand the tort "invented" in *Seaman's*, but rather took heed of the admonition in that case to "proceed with caution." *Seaman's*, 686 P.2d at 1167. *See, e.g.*, Rogoff v. Grabowski, 246 Cal. Rptr. 185 (Ct. App. 1988) (citing *Commercial Cotton* approvingly and then denying extension of the tort by finding that no "special relationship" existed between a limousine company and its customers); Martin v. U-Haul Co. of Fresno, 251 Cal. Rptr. 17, 26-28 (Ct. App. 1988) (citing *Commercial Cotton* with approval, then denying application of the new tort in the context of a franchise agreement between franchisor and franchisee); Gomez v. Volkswagen of Am., Inc., 215 Cal. Rptr. 507, 510-13 (Ct. App. 1985) (citing *Commercial Cotton* with approval, then denying application of the tort in the context of a claim by a consumer against an automobile manufacturer); Quigley v. Pet, Inc., 208 Cal. Rptr. 394, 403 (Ct. App. 1984) (denying application of the new tort remedy in the context of a contract for hauling walnuts, due to a lack of the elements of "public interest, adhesion and fiduciary responsibility"). There was a similar pattern in the federal courts. *See* Standard Wire & Cable Co. v. Ameritrust Corp., 697 F. Supp 368 (C.D. Cal. 1988); Elxsi v. Kukje Am. Corp., 672 F. Supp 1294 (N.D. Cal. 1987); Premier Wine & Spirits v. E. & J. Gallo Winery, 644 F. Supp. 1431 (E.D. Cal. 1986). This tort was extended from the insurance context to employment contracts in Cleary v. American Airlines, Inc., 168 Cal. Rptr. 722, 728-29 (Ct. App. 1980). *See, e.g.*, Gray v. Superior Court, 226 Cal. Rptr. 570, 573 (Ct. App. 1986); Khanna v. Microdata Corp., 215 Cal. Rptr. 860, 864 (Ct. App. 1985). *Commercial Cotton*, however, was the first to extend the tort to the area of banking law.

with similar characteristics"[212] to those of insurer and insured.

On the basis of the decisions in *Egan* and *Seaman's*, the court in *Commercial Cotton* concluded that

> banking and insurance have much in common, both being highly regulated industries, performing vital public services substantially affecting the public welfare. A depositor in a non interest-bearing checking account, except for state or federal regulatory oversight, is totally dependant on the banking institution to which it entrusts deposited funds and depends on the bank's honesty and expertise to protect them.[213]

The decision in *Commercial Cotton* was cited without criticism in a number of subsequent California decisions[214] and was also expressly followed by the same appellate court in the context of a suit brought not by a depositor, but by a borrower against a bank.[215] In addition, it received both negative and positive reviews by student commentators and prestigious academics alike.[216] Sadly, however, the quasi-fiduciary relationship

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212. *Seaman's*, 686 P.2d at 1166. Following the reasoning in this dictum from *Seaman's*, a subsequent case found the required similarity of characteristics in the relationship between employee and employer in the context of an employment severance contract sufficient to create a "special relationship." Wallis v. Superior Court, 207 Cal. Rptr. 123 (Ct. App. 1984). That case arose in the context of a peremptory termination by an employer of previously agreed upon termination benefits. *Id.* at 125. As such, it is part of the wrongful termination line of cases. In deciding whether a "special relationship" existed sufficient to support a claim of tortious breach of the implied covenant of good faith and fair dealing, the *Wallis* court emphasized that it was not in the least limited to employment contract concepts, rather, it held that the "similar characteristics" which would signal the existence of a "special relationship" could be found in almost any "special" kind of commercial contractual relationship. *Wallis*, 207 Cal. Rptr. at 127. In so doing, the *Wallis* court identified the following five (5) part test for identifying the "similar characteristics" necessary for determining the existence of a "special relationship" which must be present to permit the imposition of tort liability in what would otherwise be a simple contracts case: (1) inherently unequal bargaining positions; (2) non-profit motivation, i.e., objective of securing peace of mind, security; (3) inadequacy of ordinary contract damages; (4) special vulnerability of one party to harm as a result of breach of trust of the other; and (5) awareness by the other of this special vulnerability. *Id.* at 129. Subsequently, in Foley v. Interactive Data Corp., 765 P.2d 373, 396 (Cal. 1988), without directly addressing the decision or the standards set out in *Wallis*, the court reversed the earlier line of cases stemming from Cleary v. American Airlines, Inc., 168 Cal. Rptr. 722 (Ct. App. 1980), and held that there was no justification either in policy or precedent to justify extending the tort recovery allowed for breach of the implied covenant of good faith and fair dealing in insurance contracts to employment contracts. *Foley*, 765 P.2d at 395-96. The court concluded by saying that "[w]e therefore conclude that the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies" and thereby affirmed "the traditional separation of tort and contract law." *Id.* at 396.

213. Commercial Cotton, 209 Cal. Rptr. 551, 554 (Ct. App. 1985).

214. Martin v. U-Haul Co. of Fresno, 251 Cal. Rptr. 17, 26 (Ct. App. 1988); Rogoff v. Grabowski, 246 Cal. Rptr. 185, 189 (Ct. App. 1988); Multiplex Ins. Agency, Inc. v. California Life Ins. Co., 235 Cal. Rptr. 12 16-17 (Ct. App. 1988); Gomez v. Volkswagen of Am., Inc., 215 Cal. Rptr. 507, 510 (Ct. App. 1985).

215. Barrett v. Bank of Am., 229 Cal. Rptr. 16, 20 (Ct. App. 1986). For a general discussion of this case, see *supra* notes 144-154 and accompanying text.

216. Putz & Klippen, *supra* note 209, at 462-65, n.178; Kenneth W. Curtis, Comment, *The Fiduciary Controversy: Injection of Fiduciary Principles Into the Bank-Depositor and*

developed in *Commercial Cotton* was short-lived.

2. *The fall of* Commercial Cotton

Notwithstanding its initial positive reception, the decision in *Commercial Cotton* recently has been the focus of considerable judicial criticism[217] and now actually appears to have been overruled by the same court that originally decided it in *Copesky v. Superior Court.*[218] In reaching this stunning conclusion, the court in *Copesky* wrote that, "[a]bsent a drastic change in the Supreme Court's direction . . . the philosophy and trend of *Commercial Cotton* might still be healthy."[219]

The *Copesky* decision should not have come as a complete surprise, however, as the court had noted the winds of such a "drastic change" blowing from the California Supreme Court's direction in its decision in *Foley v. Interactive Data Corp.*[220] In considering the nature of these winds and their effect on the continued viability of *Commercial Cotton*, the *Copesky* court first engaged in a review of the development of the law with respect to the tort of breach of the covenant of good faith and fair dealing, then directly considered the now rather infamous "quasi-fiduciary" standard first enunciated by *Commercial Cotton.*[221] Like *Seaman's*, the facts in *Foley* arose in the context of an employment contract. In revisiting this issue, the California Supreme Court emphasized the differences between contract and tort remedies and reaffirmed that notwithstanding the exception to the general rule developed in the context of insurance contracts, only contract remedies should be available for the breach of implied contractual covenants.[222] The court then held that "we are not convinced that a special relationship analogous to that between insurer and insured should be deemed to exist in the usual employment relationship . . . . [T]he need to extend the special relationship model in

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Bank-Borrower Relationships, 20 LOY. L.A. L. REV. 795 (1987); N.E. Betsworth Note, Commercial Cotton Co. v. United California Bank: *California's Newest Extension of Bad Faith Litigation Into Commercial Law*, 16 SW. U. L. REV. 645 (1986).

217. *See* Price v. Wells Fargo Bank, 261 Cal. Rptr. 735, 738 (Ct. App. 1989) (stating that the "tort theory in appellants' cause of action for breach of the implied covenant of good faith and fair dealing is based on a recent, and already discredited, precedent: *Commercial Cotton Co. v. United California Bank*").

218. 280 Cal. Rptr. 338 (Ct. App. 1991). In *Copesky*, which was decided by the same court that originally decided *Commercial Cotton*, albeit with a number of personnel changes on the bench, the court stated that "we are convinced *Commercial Cotton*'s characterization of a bank-depositor relationship as quasi-fiduciary is now inappropriate. . . . We are therefore forced to acknowledge that our decision in *Commercial Cotton*, while in its time seemingly in harmony with the direction of the Supreme Court, turned out, after *Foley*, to be misdirected." *Id.* at 348.

219. *Id.* at 344.

220. 765 P.2d 373 (Cal. 1988). It is noteworthy that the composition of the California Supreme Court that decided *Foley* had changed rather substantially from the one that decided *Seaman's*. Only two of the seven justices that decided *Seaman's* were still sitting on the bench when *Foley* arrived.

221. *Copesky*, 280 Cal. Rptr. at 342-48.

222. *Foley*, 765 P.2d at 389-90.

the form of judicially created relief of the kind sought here is less compelling."[223]

On the basis of the *Foley* decision, the Court of Appeals in *Copesky* concluded that

> [t]here is no question but that the decision in *Foley* redirects the course of law in the area of tort recovery for breach of commercial contracts. While some may argue that the *Seaman's* tort of bad faith denial of the existence of a contract remains viable, few would contend that new broad categories of business relationships remain to be identified by the *Wallis* test as presumptively amenable to tort remedies for contact breach. Before *Foley*, one could confidently suggest that at least in two spheres of contract relationships—insurance contracts and employment agreements—a bad faith breach could give rise to tort damages. That assumption is now gone; there is only one category of business transactions which definitionally is amenable to tort actions for contract breaches, and that is insurance.[224]

Significantly, the decision in *Foley* neither specifically referred to commercial banking activities nor cited *Commercial Cotton* in text or footnotes. Despite this apparently deliberate omission, however, the *Copesky* court said that it was "most satisfied . . . that if the *Foley* court were to apply the same reasoning to the commercial banking business which it applied to employment contracts it would conclude that, in the usual case, the 'special relationship' found in insurance cases and evaluated by the *Wallis* standards would be lacking."[225]

In support of this conclusion, the *Copesky* court cited a number of post-*Foley* appellate decisions, including *Price v. Wells Fargo Bank*,[226]

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223. *Id.* at 395-96.

224. *Copesky*, 280 Cal Rptr. at 345. However, notwithstanding the decision in *Foley*, the five-part test enunciated in *Wallis* was not rejected and is still good law. The *Foley* court took notice of *Wallis* and its five-part test for a "special relationship" by specifically citing and making a detailed reference to them, without any express or implied rejection or departure from such standards, it can be persuasively argued that the *Foley* court recognized *Wallis* and its test as established precedent. The *Copesky* court came to just this conclusion when it observed that, "[l]acking any suggestion [in *Foley*] of disapproval, we conclude that the *Wallis* factors for determining [a] 'special relationship' remain viable, even if having perhaps little utility in the ordinary employment relationship." *Id.* at 345 n.10. Additionally, with regard to the reference in *Seaman's* that, "[n]o doubt there are other relationships with similar characteristics and deserving of similar legal treatment," the majority in *Foley* explained that, rather than signaling the court's approval of the extension of tort remedies, "[i]f anything, the reference highlighted the fact that this question remained to be decided by this court." *Foley*, 765 P.2d at 392.

225. *Copesky*, 280 Cal. Rptr. at 345.

226. 261 Cal. Rptr. 735 (Ct. App. 1989). Careau & Co. v. Security Pac. Business Credit, Inc., 272 Cal. Rptr. 387, 403-04 (Ct. App. 1990) (finding no special relationship to exist in the bank—borrower relationship); Mitsui Mfrs. Bank v. Superior Court, 260 Cal. Rptr. 793 (Ct. App. 1989) (same justice on the court that initially wrote its decision in *Commercial Cotton*, stating that "[w]e reject [the] real parties' argument that the tort doctrine which has been extended only to situations where there are unique fiduciary-like relationships between the parties should encompass normal commercial banking transactions." *Id.* at 795; Despite its cited authority, the *Copesky* court went on to note that the reasoning in *Com-*

and then proceeded to apply each of the *Wallis* standards to the commercial banking arena on its own accord. With regard to the first of the *Wallis* standards, "inherently unequal bargaining positions,"[227] the *Copesky* court found that "ordinarily" a commercial entity and a bank are not in inherently unequal bargaining positions.[228] It noted that banks offer a standard product and operate in a very competitive business climate, and thus concluded that no "aspect of common banking transactions . . . suggests to us that banks in general are, or this bank in particular was, in a superior bargaining position."[229]

Turning to the second of the *Wallis* standards, "non-profit motivation," or the goal of achieving peace of mind, security,"[230] the *Copesky* court quickly dispensed with the issue as it applies to the commercial banking arena. It observed that, unlike insurance contracts, "loan agreements, which are essentially the buying and selling of money, are highly profit motivated."[231] The court further noted that, although the security of an institution is a central factor in choosing a bank, it is hardly an overriding factor as is the case with insurance generally.[232]

Similarly, regarding the third of the *Wallis* standards, inadequacy of ordinary contract damages,"[233] the court concluded that any inadequacy there may be in the banking context had nothing to do with the nature of the banking relationship. The court observed that to the extent that damages recoverable due to a bank cashing a forged check were insufficient to cover the losses proximately caused by the bank's action, the typical inadequacy of judicial remedies in commercial contexts was to blame.[234]

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mercial Cotton "has not been unanimously rejected." *Copesky*, 280 Cal. Rptr. at 346 n.11. In that footnote the court pointed out that Justice Johnson, dissenting in Lee v. Bank of Am., 267 Cal. Rptr. 387 (Ct. App. 1990), "would affirm the continued vitality of *Commercial Cotton*. His analysis of the *Wallis* five points results in the conclusion that they fit the bank-depositor relationship, thus constituting it as a 'special relationship' appropriate for utilization of tort claims when the deposit contract is breached. We respectfully disagree with Justice Johnson's approach." *Id.*

227. Wallis v. Superior Court, 207 Cal. Rptr. 123, 129 (Ct. App. 1984).

228. *Copesky*, 280 Cal. Rptr. at 346.

229. *Id.*

230. *Wallis*, 207 Cal. Rptr. at 129.

231. *Copesky*, 280 Cal. Rptr. at 346. The court also drew a distinction here, following the reasoning in *Foley*, between the employment and the insurance relation. In the insurance relation, there is, the court observed

> a unique economic dilemma faced by the insured whose insurer refuses in bad faith to pay policy benefits. The insured has lost the very benefit for which he contracted, and is not in a position to seek alternative relief from competitors. The employee, however, has not bargained for any similar type of "protection" and the breach of the employment contract causes damages essentially similar to those resulting from breaches of other kinds of contractual agreements—such as the refusal to honor a contract for the supply of goods vital to a small dealer's business. We conclude that the breach of a banker's agreement with its depositor similarly results in damage typical to all commercial contracts.

Id. at 347 n.13.

232. *See Copesky*, 280 Cal. Rptr. at 346.

233. *Wallis*, 207 Cal. Rptr. at 129.

234. *Copesky*, 280 Cal. Rptr. at 347. For example, absent a specific contractual clause

This problem, they noted, constitutes a "defect in our jurisprudential system."[235] The court therefore concluded that "[n]o one . . . involved in commercial litigation these days can be made completely whole."[236] In contrast, the court concluded that the type of losses that *Wallis* envisioned when it enunciated its third standard were those peculiarly associated with denial of payment of insurance proceeds or . . . the peremptory interruption of monthly termination payments to an aged retired employee."[237]

The fourth and fifth components of the *Wallis* standards, one party's special vulnerability to harm as a result of breach of trust of the other, and awareness by the other of this special vulnerability,[238] can be accurately characterized as two sides of a single coin. Accordingly, the *Copesky* court considered these two standards together. In so doing, the court sought to distinguish "unusual" banking arrangements from "ordinary" ones. The court described the "unusual banking arrangements" as consisting of those, "whereby minors or other dependent people specifically inform the bank of their complete dependence upon the liquidity of their bank account."[239] In contrast, the court noted that "ordinary" checking accounts are not of this nature.[240]

Having made this distinction clear, the court next turned to the type of "vulnerability" envisaged by the *Wallis* court. Its analysis ended with the conclusion that anyone who loses money as the result of a breach of a commercial obligation considers himself to be damaged and feels a sense of vulnerability.[241] Like the damages factor, the court considered this type of vulnerability to be common to all commercial transactions and not necessarily a function of the nature of the typical bank-depositor relationship. Accordingly, the court concluded that this vulnerability was too common to be a "special vulnerability" deserving of fiduciary protections.[242]

Although not one of the *Wallis* criteria, the *Copesky* court also addressed the issue of "public interest" raised by the court in *Commercial*

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to that effect, the inability to recovery attorney's fees and the practical costs of litigation.

235. *Id.*

236. *Id.*

237. *Id.*

238. *Wallis*, 207 Cal. Rptr. at 129.

239. *Copesky*, 280 Cap. Rptr. at 347.

240. *Id.* The court also noted that under the facts of *Copesky*, the commercial checking account of the plaintiff was "so fluid its owners did not notice the theft of some $32,000 for over a period of 18 months." *Id.* Apparently, the court concluded from this fact that the plaintiffs did not have the kind of "complete dependence upon the liquidity of their bank account" that it considered necessary in order to classify the arrangement as "unusual." *Id.*

241. *Id.*

242. *Id.* However, the court did not give any clues as to what the "sort of vulnerability envisaged by the *Wallis* criteria" would be. Rather, it simply concluded by negative inference, that whatever, that "sort" was, the typical relationship between bank and depositor was so commercially normative that it simply could not be included within ambit of the fourth or fifth *Wallis* factors. *Id.*

Cotton.[243] In a strikingly superficial manner, the court concluded that it found nothing in the status of the banking industry sufficiently important to the public welfare to trigger any sort of impact on the analysis of whether a fiduciary relationship exists.[244] In support of this rather sweeping and summary dismissal of the importance of the banking industry to the welfare of the public interest, the court merely cited a student comment in a law review, which had concluded that it was "absurd" to consider the banking industry to occupy a special or particularly noteworthy position with respect to the public interest.[245]

In considering the disputed phrase from *Commercial Cotton* that "[t]he relationship of bank to depositor is at least quasi-fiduciary,"[246] the *Copesky* court first reviewed the authorities, which had consistently held that the relationship between a bank and its depositor was not a fiduciary one, but merely one of debtor to creditor.[247] Presuming that the *Commercial Cotton* court was likewise aware of this precedent, the *Copesky* court then decided that *Commercial Cotton* surely did not "purport to classify the relationship actually as 'fiduciary.' "[248]

Having thus concluded what *Commercial Cotton* was *not* purporting to do, the court then attempted to divine what *Commercial Cotton* did in fact mean. In pursuit of this goal, the *Copesky* court first sought to define the term "quasi" by turning to its dictionary definition. It found the term defined as "seeming or seemingly; in the nature of; nearly."[249] The court then noted the demeaning quality of the term "quasi," as identified by Professor Corbin, who explained that "the term *quasi* is introduced as a

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243. *Id.* The *Copesky* court noted that *Commercial Cotton* did not rely on or even utilize the Wallis five-part standard. Instead, *Commercial Cotton* relied on those factors identified by *Egan* and *Seaman's*—public interest, adhesion, and fiduciary responsibility. Having already addressed and in its view discounted the issue of adhesion, the *Copesky* court then turned to a brief discussion of public interest.

244. Copesky v. Superior Court, 280 Cal. Rptr. 338, 347 (Ct. App. 1991).

245. *Id.* (citing Kenneth W. Curtis, Comment, *Fiduciary Controversy: Injection of Fiduciary Principles Into the Bank-Depositor and Bank-Borrower Relationship*, 20 LOY. L.A. L. REV. 795, 816-17, 817 (1987). The student author concluded that *Commercial Cotton*'s concern with the public interests at stake in the banking industry was unfounded and that its concept of

> "affected with the public interest" can be applied to common carriers, theaters, restaurants, inns/motels, food retailers, garbage collectors, doctors and landlords. The list is virtually endless. Therefore, it would be absurd to single out banks as having a "special relationship" with its customers merely because banking is affected with the public interest.

Id. In contrast, the court in *Commercial Cotton* extended a tort first identified with the insurance industry into the banking arena based on its conclusion that "banking and insurance have much in common, both being highly regulated industries performing vital public services substantially affecting the public welfare." *Commercial Cotton*, 209 Cal. Rptr. at 554.

246. *Commercial Cotton*, 209 Cal. Rptr. at 554.

247. *Copesky*, 280 Cal. Rptr. at 347 (citing Lawrence v. Bank of Am., 209 Cal. Rptr. 541, 545 (Ct. App. 1985); Morse v. Crocker Nat'l Bank, 190 Cal. Rptr. 839, 842 (Ct. App. 1985)).

248. *Id.* at 348.

249. *Id.* (citing BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE 457 (1987).

weasel word that sucks all the meaning of the word that follows it."[250]

The court then concluded that because of the manner in which the term "quasi" was employed by *Commercial Cotton*, and in light of the fact that there were no citations of authorities supporting its use of the phrase, "quasi-fiduciary," that *Commercial Cotton*'s use of that phrase was not meant to question existing authorities regarding the debtor-creditor relationship of banks and depositors.[251] Rather, by using the "quasi-fiduciary" language, the court in *Commercial Cotton* was seeking:

> only a shorthand phrase to describe attributes in the relationship which are similar to some of the attributes of a true fiduciary relationship. The court was, simply, grappling with the criteria described in *Egan* and *Seaman's* . . . for establishing [a] "special relationship," and noting that some contractual features of a banking relationship establish elements of reliance and trust which "seem like" or are "in the nature of" obligations resulting from a true fiduciary relationship.[252]

Although concluding that *Commercial Cotton* was not attempting to strike out into new territory when it adopted the phrase "quasi-fiduciary," the *Copesky* court nevertheless disapproved of its use.[253] They based this disapproval on two grounds, (1) that the use of such "loose characterizations" were both "unhelpful and fraught with analytic pitfalls" and (2) that such characterizations could lead to "importing uncritically the entire cargo of fiduciary obligations into the port of . . . the ordinary bank-depositor relationship."[254] In light of the foregoing reasoning and the decision in *Foley*, the court distanced itself from *Commercial Cotton* by concluding that the term "quasi-fiduciary" is now "inappropriate" and that their own decision in that case "while seemingly in harmony with the direction of the Supreme Court, turned out, after *Foley*, to be misdirected."[255]

D. Discrete Aspects of the Bank-Customer Relationship Which Give Rise to Fiduciary Obligations by their Very Nature

1. Loan processing

Some courts have distinguished between the common component parts of borrower-lender relationship, recognizing some as having attendant fiduciary duties on the part of the lender while others do not. Although reaffirming the customary understanding that in "most instances

250. *Id.* (citing ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 19 (1963).
251. *Id.*
252. *Id.*
253. *Id.* at 348 n.14.
254. *Id.* (citations omitted).
255. *Id.* at 348. Thereafter, the court acknowledged the accuracy of *Price* and *Careau* as being indicative of the true state of the law in this area, and held that "the ordinary bank-customer relationship [is] not a special relationship giving rise to tort remedies when the bank unreasonably, and even in bad faith, denies liability on a contract or interposes spurious defenses." *Id.* at 348-49.

the relationship of a creditor to his debtor [is] governed by the principles of freedom of contract and [is] not a fiduciary relationship," the Ohio Supreme Court in *Stone v. Davis*[256] nevertheless drew a sharp distinction in this regard between the negotiation of the terms of the loan and the bank's processing of the loan once it is in place.[257] In *Stone*, a young couple secured a loan from a local bank in order to finance their purchase of a dairy farm. Shortly thereafter, the farm's cows contracted a reproductive disease and had to be sold, causing the borrowers to fall behind on their payments to the bank.[258] However, before they could satisfy their indebtedness, the husband died in a motorcycle accident and the bank subsequently foreclosed its loan against the young widow in her capacity as co-debtor.[259] The trial court found that at the time of the loan the bank had neither taken any steps to procure mortgage insurance for the borrowers nor advised them that they were to procure it for themselves.[260] As a result, no mortgage insurance was ever obtained.

Although denying the allegation that it did not advise the borrowers regarding the need for and the mechanics of obtaining mortgage insurance, the bank insisted that it had no duty to do so because the parties were in an arm's-length debtor-creditor relationship.[261] In response, the court held that

> while a bank and its customer may be said to stand at arm's-length in negotiating the terms and conditions of a mortgage loan, it is unrealistic to believe that this equality of position carries over into the area of loan processing, which customarily includes advising the customer as to the benefits of procuring mortgage insurance on the property which secures the bank's loan.[262]

The court based this conclusion on both the individual facts of the case as well as on broader policy considerations. The court found that where, as here, there is a young couple, apparently dealing with the complex mortgage process for the first time, it could not be doubted that their every action was guided by the loan officers of the bank, upon whom they justifiably relied as experts in the area of loan processing.[263] Moreover, under such circumstances, the court concluded that "both sides to the loan transaction must have understood that a special trust or confidence had been reposed in [the bank] to advise and assist [the borrowers]

256. 419 N.E.2d 1094 (Ohio), *cert. denied*, 454 U.S. (1981).

257. *Id.* at 1097-98. *See also* Blon v. Bank One, 519 N.E.2d 363 (Ohio 1988) (citing *Stone v. Davis* with approval, but distinguishing it on its facts to find in favor of the bank on a claim of failure to disclose finder's fee by borrower); Logsdon v. Nat'l City Bank, 601 N.E.2d 262, 270 (Ohio C.P. 1991) (finding against the bank on a claim of improper conduct in connection with the processing of loans with the plaintiffs and citing *Stone v. Davis*).

258. *Id.* at 1095-96.

259. *Id.* at 1096.

260. *Id.*

261. *Id.* at 1097.

262. *Id.* at 1098.

263. *Id.*

in procuring the insurance."[264] Accordingly, the court held that the bank both owed and had breached a fiduciary duty to the borrowers.[265]

Relying on public policy for further support of its conclusions, *Stone* noted that its holding was supported by the existence of federal truth in lending laws.[266] In enacting such legislation the court noted that "Congress implicitly recognized that, in matters integrally related to the complex loan processing procedure utilized in the modern banking system, the principle of freedom of contract must be aided, the arm's length bargaining assisted, by imposing certain duties of disclosure upon banks" in order to promote the informed use of credit.[267] The court also emphasized that because mortgage insurance serves to protect the bank's investment in a loan, the bank does not act as a disinterested advisor, but rather has a "direct pecuniary interest in inducing [its borrowers] to procure it."[268]

Similarly, in the recent case of *Steelvest, Inc. v. Scansteel Service Center, Inc.*,[269] the Kentucky Supreme Court noted the traditional view that the relationship between a bank and depositor is governed by principles of debtor-creditor,[270] but went on to point out that "services to borrowers and pledgors may support a finding that a bank, in taking a borrower's note and collateral, falls under a fiduciary duty to disclose material facts affecting the loan transaction."[271] The implication is that the duty is much more likely to accrue once negotiation has ended and processing begun. Other courts have further held that a fiduciary duty will arise where a borrower or even a loan applicant deposits escrow or other money with the potential lender.[272] These cases support the proposition that different standards of care should be in effect in the different stages of the relationship.

2. *Confidential relationships*

It has been consistently held that while the lender-borrower relationship is not per se a fiduciary one, it may become fiduciary if a business of confidential relationship induces one party to lessen the normal standard of care and vigilence employed when dealing with a stranger.[273] Such con-

264. *Id.*
265. *Id.*
266. *Id.*
267. *Id.*
268. *Id.* The court also noted that this position is even further supported by the fact that bank will frequently act as collection agents for the mortgage insurance premiums paid by their borrowers, collecting the required amounts directly from the borrowers as part of the monthly payment schedule, and "then remitting the collected premiums to the insurance company, receiving in return a percentage commission for this service." *Id.* at 1098-99.
269. 807 S.W.2d 476 (Ky. 1991).
270. *Id.* at 485.
271. *Id. See also* Henkin, Inc. v. Berea Bank & Trust Co., 566 S.W. 2d 420 (Ky. Ct. App. 1978) (finding that alleged facts were sufficient to establish fiduciary duties in the processing as opposed to the negotiating of a loan).
272. *E.g.*, High v. McLean Fin. Corp., 659 F. Supp. 1561, 1568 (D.D.C. 1987).
273. *See e.g.*, United Fire & Casualty Co. v. Nissan Motor Corp., 433 P.2d 769, 771

fidential relationships arise when, "one party has justifiably reposed confidence in another."[274] Thereafter, the confidential relationship gives rise to a fiduciary one when "there is a repose of trust by the customer along with an acceptance or invitation of such trust on the part of the lending institution."[275]

It has also long been held that "banks present a constant invitation to intending borrowers, and thus subject themselves to whatever implication or obligation is to be drawn from that fact."[276] Consequently, when a bank, through its loan officer, improperly discloses or otherwise misuses the information supplied to him in confidence by a borrower or prospective borrower, the bank must be held accountable under an equitable remedy such as fiduciary duty. In a frequently cited quotation from *M.L. Stewart* to this effect, that court wrote:

> [i]f a person applies for a loan, and in connection with that application discloses his purpose to avail of a bargain which he had not as yet closed by contract, and of which the lender had not previously heard, the courts, whether of law or equity, would afford some form of adequate relief in case the applicant was forestalled in his project by his lender.[277]

The Supreme Court of Kentucky recently added to this line of reasoning in the case of *Steelvest, Inc., v. Scansteel Service Center, Inc.*[278] In that case, a bank which loaned money to a corporation was approached by a known director and officer of the corporation seeking to obtain a commercial loan from the bank for his own behalf.[279] He disclosed his intention to use the funds to form a company which would compete with the borrower corporation.[280] The bank granted the loan,[281] the new com-

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(Colo. 1967); Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 23 (Colo. Ct. App. 1982).

274. Page v. Clark, 592 P.2d 792, 798 (Colo. 1979).

275. *Dolton*, 642 P.2d at 23. *See also* Warsofsky v. Sherman, 93 N.E.2d 612 (Mass. 1950) (finding fiduciary duty); Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1977) (finding fiduciary duty); M.L. Stewart & Co., v. Marcus, 207 N.Y.S. 685 (Sup. Ct. 1924) (finding fiduciary duty). In each of these cases the borrower, or prospective borrower went to the bank seeking funds with which to purchase certain property. In connection therewith, they disclosed the details surrounding the property they were seeking to a loan officer who was previously unaware of its availability. Thereafter, the loan officers, on the basis of the information supplied to them by the borrower or prospective borrower, purchased the property which the customer was seeking to buy for their own account. In each case the courts held that the loan officer had acquired a fiduciary duty by virtue of receiving the confidential information regarding the available property and breached that duty by purchasing the property on his own account to the detriment of the customer who had supplied that information under circumstances that justifiably suggested a confidential relationship.

276. *M.L. Stewart*, 207 N.Y.S. at 692.

277. *Id.*

278. 807 S.W.2d 476 (Ky. 1991).

279. *Id.* at 485.

280. *Id.*

281. *Id.*

pany successfully competed,[282] and the old company was forced into bankruptcy, partially due to the increased competition from the new company.[283]

The borrower company sued the former officer for breach of his fiduciary duty and also sued the bank as an aider and abettor.[284] In reversing the summary judgment that had been granted in favor of the bank below, the Kentucky Supreme Court observed that by lending funds to a potential competitor of one of its borrower customers with the knowledge that this could be detrimental to the client, the bank may have breached a fiduciary duty.[285] Moreover, the court found that the lender might have improperly used information gained from the original borrower in the processing of the loan to the would-be competitor.[286]

Steelvest thus reaffirms the long line of cases holding that where lenders acquire confidential information from a borrower in the process of granting a commercial loan, they may thereby acquire a fiduciary obligation to that borrower with respect to that information. Under *Steelvest*, this reasoning is extended to the point where the lender may not with impunity turn around and use that very information as part of its decisional base in order to grant a loan to a competing enterprise.[287]

III. A Critique of the Law

A. *Definitional Deficiency*

Like Lord Chelmsford[288] before them, most courts that have considered a fiduciary claim have begun with an attempt to define the phrase

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282. *Id.* at 479.

283. *Id.*

284. *Id.* The *Steelvest* court noted that "it has been held that a person who knowingly joins with or aids and abets a fiduciary in an enterprise constituting a breach of the fiduciary relationship becomes jointly and severally liable with the fiduciary for any profits that may accrue." *Id.* at 485. *See also* Jackson v. Smith, 254 U.S. 586 (1921) (holding that a receiver violates his fiduciary duty when he places himself in a position in which his personal interests may be in conflict with those of his trust); Irving Trust Co. v. Deutsch, 73 F.2d 121 (2d Cir. 1934) (reaffirming the equitable rule that fiduciaries may not assume positions in which their individual interests might conflict with those to whom they owe a duty of trust).

285. *Steelvest*, 807 S.W.2d at 486.

286. *Id.*

287. *Id.* Expectedly, the bank argued that such a rule would have a chilling effect, and present an unreasonable imposition upon lending institutions and thereby "preclude the making of commercial loans to competitors" of existing borrowers. *Id.* The court dismissed this fear as "paint[ing] . . . with too broad a brush" partly because any fiduciary duty that arose in such a context could be easily discharged by the bank by simply disclosing the information to the existing borrower. *Id.* It is not per se the bank's actions which constitute a breach of its fiduciary duty in this regard, but rather, its silence, its passivity in taking no action. The fiduciary obligation which arises in the context of the inviting, imparting and reception of confidential information, is first, a duty not to compete, and second a duty to disclose material information. *Id.*

288. Tate v. Williamson, 2 Ch. 55 (1866).

"fiduciary duty."[289] With disappointing consistency, most of those courts have invoked strikingly similar language in defining the phrase. Many have done so in such lockstep fashion that they continually cite other such judicial attempts as authority for the accuracy of the definition that they employ in the case at issue.

The problem with this judicially self-dependent definitional process is, as one scholar has noted, rather than truly defining the phrase, they "merely describe"[290] the kind of situations in which the duty has been found to exist in the past. In so doing, the courts then examine existing prototypes of fiduciary obligations, such as agency, bailment, and trusts and seek to import those concepts into the case at hand either by way of analogy or by use of metaphor.[291] These analogies are frequently inconsistently applied and are often simply inappropriate; such as analogies based on notions of contract law.[292]

A more useful and ultimately more enlightened approach to dealing with questions of fiduciary obligation would be to begin with an understanding of its historical nature, development, and functional policy goals. From there a court could decide, not whether the current situation looks like one in which a fiduciary obligation has been imposed in the past, but rather, given the issues and positions of the relevant parties, whether that situation is consistent with the historical equitable foundations of the obligation and the current policy goals underlying the judicial policing of

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289. *See, e.g.*, M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 688-91 (Sup. Ct. 1924); Miller v. U.S. Bank, 865 P.2d 536 (Wash. Ct. App. 1994); Tokarz v. Frontier Fed. Sav. & Loan Ass'n, 656 P.2d 1089, 1092 (Wash. Ct. App. 1982).

290. Frankel, *supra* note 28, at 805.

291. DeMott, *supra* note 29 at 880. In this context, the term "metaphor" is defined as the process of treating two or more dissimilar things in similar fashion in order to draw upon or highlight their functional similarities. *Id.* at 880 & n.3. *See also* Frankel, *supra* note 28, at 806.

292. *See* DeMott, *supra* note 29, at 891 where the author points out that

> the metaphorical use of technical legal terms, like "contract" or "agency" . . . has even less to commend it in legal contexts where the potential for confusion is so great. Even if we were persuaded by philosophical arguments that, *at some level*, all language is rooted in metaphorical origins, ultimately traceable to essential equations between verbal symbols and nonverbal phenomena, we should still be disinclined to excuse the metaphoric use of technical terms in workaday contexts like law. As C.S. Lewis wrote, "That metaphors misread as statements of fact, are the source of monstrous errors, need hardly be pointed out." . . . The evolution of the law of fiduciary obligation illustrates, perhaps more powerfully than most bodies of law, the power of analogy in legal argumentation. Courts considering whether to impose a fiduciary constraint in a novel context rely heavily on comparisons to more conventional contexts in which the constraint does apply. Although some commentators find this pattern intellectually unsatisfying, its pervasiveness and persistence suggest that it is an inevitable aspect of fiduciary analysis.

Id. (citing C.S. Lewis, *Bluspels and Flalansferes*, *in* THE IMPORTANCE OF LANGUAGE 36 (M. Black ed. 1962)). *See also* J.C. SHEPERD, LAW OF FIDUCIARIES 5 (1981) (discussing the historical anomalies on which the modern law of fiduciaries is based); Frankel, *supra* note 28, at 807 (noting that "mechanical analogies to the features of prototypical fiduciary relations result in rules that are confusing and inappropriate").

the relationship involved.

In this way, the organic integrity of the law would be preserved and the application of fiduciary obligation would be allowed to advance into new situations where it could serve dual policy goals, protect the freedom of parties to contract as they wish, and at the same time deter creative opportunistic behavior[293] that seeks to take unbargained for advantage of opportunities which appear on the outer limits of the current legal regime. This approach is particularly appropriate, where, as Professor Frankel has pointed out, our society is witnessing an unprecedented expansion of interdependence, where freedom from unbargained for coercion has resulted in a society "based predominantly on fiduciary relations."[294]

B. Failure of Purpose

Another problem apparent in the judicial consideration of fiduciary obligation claims is their consistent failure to adequately consider the purposes of the obligation. As indicated in Section II (D),[295] from an economic point of view, one of the most significant purposes of the fiduciary obligation in commercial relationships is the reduction of transaction costs. Because of the unanticipated wealth transfer inherent in opportunistic behavior, the party that is most vulnerable to such opportunism will seek the least costly method of self-protection available in order to deter such behavior. Fiduciary obligation is one of the least costly self-protection regimes available, and such costs do not necessarily increase where the parties have explicitly negotiated for such protection rather than where they operate within a context where the law supplies the obligation as a default rule.[296]

It is important to note that vulnerability to opportunism is not necessarily a function of a lack of bargaining power or an undersupply of commercial sophistication. Rather it is more typically a function of the relational contracting context itself, where the complexities and potential range of contingencies for misbehavior[297] by either or both parties are

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293. Opportunistic behavior is best understood as "when a performing party [to a contract] behaves contrary to the other party's understanding of their contract, but not necessarily contrary to the agreement's explicit terms, leading to a transfer of wealth from the other party to the performer." Timothy J. Muris, *Opportunistic Behavior and the Law of Contract*, 65 MINN. L. REV. 521, 521 (1981); *See* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTI-TRUST IMPLICATIONS (1975); Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV., (May 1980) at 356; Oliver E. Williamson, *Transaction Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979). Hereinafter, such conduct shall be referred to simply as "Opportunistic Behavior."

294. Frankel, *supra* note 28, at 798.

295. *See supra* notes 256-287 and accompanying text.

296. For an expanded discussion of the "relational contract," see *supra* note 70.

297. *See* Fischel *supra* note 1, at 135-40. Professor Fischel provides an extended discussion of the opportunities for and the problems associated with misbehavior by both lender and borrower, then demonstates how this reciprocal concern leads both parties to enter into various kinds of monitoring and bonding mechanisms which, while extremely beneficial to both parties, do not operate costlessly. *Id.*

simply too great to justify the time and expense that would be required *ex ante*, to expressly provide for them all by contract. The fiduciary obligation is particularly well suited to this situation, because the vulnerability of the entrustor to misbehavior by the fiduciary is likewise not the result of an inequality in bargaining power or sophistication. Rather, it stems from the very nature of the fiduciary relation. The delegated power to the fiduciary is a double-edged sword which enables him to both benefit and injure the entrustor because "the purpose for which the fiduciary is allowed to use his powers is narrower than the purposes for which he is capable of using the power."[298]

However, the judicial decisions where borrowers have claimed the existence and breach of a fiduciary duty frequently cite the relative sophistication and expertise of the borrower as a justification for rejecting the recognition of such an obligation by the lender.[299] Similarly, the courts often cite the lack of sophistication and expertise of the borrower in recognizing such an obligation by the lender.[300] Obviously, a more thorough examination by these courts of the nature of the fiduciary obligation and the important purposes it serves in terms of both bonding and monitoring, would be helpful in determining the "relevance" of the parties' relative sophistication and bargaining power before mechanically rejecting one characterization and allowing another, simply on the basis of relative sophistication. However, not only do the courts conspicuously fail to engage in any such analytical examination of the relevance of sophistication in these cases, but they also appear completely unaware that it might even be an issue.[301] As a direct consequence, the courts tend to "simply eviscerate bonding mechanisms that benefit both borrowers and lenders."[302]

While the courts may be blind to the benefits of such a relationship, the parties surely are not. Because the desire to economize on transaction

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298. Frankel, *supra* note 28, at 810.

299. *See, e.g.*, Denison State Bank v. Madeira, 640 P.2d 1235, 1244 (Kan. 1982).

300. *See, e.g.*, Stone v. Davis, 419 N.E.2d 1094, 1098 (Ohio), *cert. denied* 454 U.S. 1081 (1981).

301. For example, an attorney clearly owes a fiduciary obligation to his client. However, if that client also happens to be an attorney, with an equal degree of sophistication and expertise, the fiduciary duty owed to him is not otherwise negatively affected by these qualities in the client. Similarly, where the trustee of a trust, who clearly owes a fiduciary duty to the trust's beneficiary, finds that the beneficiary is as skilled and experienced a financial expert as himself, his fiduciary obligations are not otherwise negatively affected by those qualities in the beneficiary. One can easily imagine countless similar examples. The point, however, is that in the typical and traditional fiduciary relationship, the expertise, sophistication, and experience of the beneficiary or entrustor is never considered as a justification for rejecting the recognition of a fiduciary duty. The duty exists in those circumstances by virtue of the nature of the relationship and the position of the parties, regardless of their relative sophistication or expertise. It is only when the question of a fiduciary duty is raised in the context of the relationship between a bank and its customer that the relative sophistication of the parties is raised as a justification for rejecting the recognition of such an obligation.

302. Fischel, *supra* note 1, at 146.

costs is, in fact, reciprocal, both the lender and the borrower are motivated to create a relationship that has a mix of both monitoring and bonding arrangements.[303] In this way, both parties can have some security that misbehavior by the other will be either deterred or adequately compensable if it occurs. Consequently, notwithstanding their written loan documents, both lender and borrower operate within the context of an extremely interactive relationship where many of the actual terms that control the day to day performance of the loan are in the form of agreements between the parties which are not reduced to writing, and in fact are often at odds with the express terms of the loan documents. These agreements frequently involve granting the borrower additional flexibility in performing and the lender additional discretion in evaluating that performance.[304] These agreements work well as long as the loan is performing; however, when a borrower runs into trouble, the lender is then placed in the moral dilemma of either denying that the oral agreements were made, or citing the parol evidence rule to exclude their enforceability, thus returning to the express terms of the loan documents to control the terms of the relationship.[305]

The fact that the lender has recourse to the parol evidence rule in order to deny liability for any oral promises or agreements reached with the borrower which are contrary to the terms of their written agreement provides fertile ground for opportunistic behavior on the part of the lender. This is not to suggest that there may not be many occasions for a lender to properly invoke the rule. When evaluating a claim by a borrower that such oral promises were made, however, a court should carefully consider the bonding context of the relationship in which such promises are both normative and beneficial to both parties. In short, for a court to insist that any and all terms which control the borrowing relationship must be reduced to writing, even where the written loan documents expressly require it, is to ignore the relational context of the lender-borrower relationship. In that context, such a written reduction is frequently not done because the advantages of doing so are far outweighed by the economizing and bonding advantages of doing precisely the opposite. A deeper analysis which recognizes this relational and economic reality is necessary but, all too often, it is completely absent in judicial opinions considering claims of breach of fiduciary duty in the lender-borrower context.

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303. *See* Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

304. Such agreements are precisely the type of bonding arrangements that parties to a relational contract seek to create and are, therefore, beneficial to both lender and borrower. *See* Fischel, *supra* note 1 at 143.

305. *See, e.g.*, Bank of Am. Nat'l Trust & Sav. Ass'n v. Pendergrass, 48 P.2d 659, 661 (Cal. 1935); Bank of Am. Nat'l Trust & Sav. Ass'n v. Lamb Fin. Co., 3 Cal. Rptr. 877, 880 (Ct. App. 1960).

C. *Special Relationship Problems*

As the court in *Reid v. Key Bank of Southern Maine, Inc.*[306] pointed out, only a small number of jurisdictions today hold that a bank cannot, under any circumstances owe a fiduciary duty to a customer.[307] A sweeping prohibition based on the projected disruption of "a whole system of credit that exists in the economic marketplace of this country"[308] is simply too rigid and narrow to account for the economic and commercial realities of how banks and their customers actually interact in the conduct of ordinary business transactions. Thus, the question is more accurately characterized, not as whether a fiduciary obligation can exist between a bank and its customer, but rather when and under what conditions such an obligation arises.

Although the jurisdictions are clearly split on this issue,[309] the overwhelming majority favor the recognition or imposition of such a duty, but only in those instances where the customer reposes trust and confidence in the bank and the bank knowingly and willingly accepts it, or in what has been variously described as "special circumstances."[310] These "special circumstances," as was previously discussed, have been loosely grouped into three general categories: (1) where the borrower reposes special trust and confidence in the lender; (2) where the borrower receives and relies on advice given by the lender; and (3) where the lender gains superiority, influence, dominion, and control over the borrower.[311] The quest to define and identify the "special circumstances" which give rise to a fiduciary obligation from a bank to its customer has become somewhat akin to a judicial search for the holy grail. The judicial struggle has occupied a great deal of time and energy in courts at every level and in every state and jurisdiction.

The results, however, are far from encouraging. The decisions are not only confusing, but are often inconsistent and utterly lacking in analytical depth. For example, some require simply a reposing of a "special trust and confidence" by the customer in the bank;[312] others require that such special trust and confidence must also lead to the bank actually giving the customer advice, upon which he relies to his detriment;[313] others require such reliance to be reasonable;[314] and still others require that such reliance on advice must result in the bank thereby acquiring control and do-

306. 821 F.2d 9 (1st Cir. 1987).

307. *Id.* at 17.

308. *Id.* (quoting from the district court opinion).

309. For a detailed discussion and review of case law pertaining to the various requirements for the establishment of fiduciary duties, see *supra* notes 96-194 and accompanying text.

310. *Reid*, 821 F.2d at 17.

311. For a detailed discussion of the categories of "special circumstances," see *supra* Section II (B) (1), (2) and (3).

312. *See, e.g.*, Central State Stamping Co. v. Terminal Equip. Co., 727 F.2d 1405 (6th Cir. 1984); Barnett Bank v. Hooper, 498 So. 2d 923 (Fla. 1986).

313. *See, e.g.*, Barrett v. Bank of Am., 229 Cal. Rptr. 16 (Ct. App. 1987).

314. *See, e.g.*, Stewart v. Phoenix Nat'l Bank, 64 P.2d 101 (Ariz. 1937).

minion over the borrower and that such control and dominion be the result of a weakness, mental infirmity, or other disability on the part of the customer.[315] These decisions have led to massive confusion and a notable lack of certainty and guidance to banks and customers alike on how they should conduct themselves in their dealings with one another, and to the courts that are called upon to police their relationship. Such pervasive uncertainty may actually encourage expensive litigation, thereby raising the costs of transactions for all parties concerned and discouraging lenders and borrowers from engaging in the very type of bonding and monitoring activities designed to lower costs. This could in turn result in increased costs ultimately to be borne by borrowers as the banks pass them along. In the end, there exists the situation where the borrower, who often is the least able to control such cost increases and the least able to bear them, would most often be required to bear the costs. This situation cannot help but drive many borrowers out of the borrowing market, deter others from entering, and consequently reduce the demand and the availability of funds for starting, improving and expanding business enterprises.

In an interesting juxtaposition, a careful review of *Commercial Cotton* and the controversy it spawned, including the decision in *Copesky*, which overruled it, reveals that *Commercial Cotton* was actually just another chapter in the "hunt for special circumstances," albeit from a fresh perspective entirely. While many courts were searching for some definitive account of what special circumstances justified the imposition of fiduciary duties on lenders, *Commercial Cotton* was searching for some relationship between a bank and its customer that would permit characterizing it as a "special relationship" sufficient to justify the imposition of the new tort of breach of the covenant of good faith and fair dealing, in order to expand the range of damages from simple contract to those traditionally found in the tort context. *Commercial Cotton* found this "special relationship" in what it regarded as the "quasi-fiduciary" relationship between a bank and its customer.[316] Thus, *Commercial Cotton* could be accurately read as having characterized the entire relationship between a bank and its customers as a "special relationship."[317]

Although *Commercial Cotton*'s "quasi-fiduciary" characterization of the bank-customer relationship has now been overruled by the decision in *Copesky*, it would be inaccurate to conclude from this that the search for the elusive "special relationship" is now at an end. Quite the contrary, in fact, because the *Copesky* court specifically noted that depending on the circumstances, such "special relationships" were still quite possible, notwithstanding its holding, in both the bank-customer relationship gener-

315. *See, e.g.*, Paskas v. Illinois Fed. Sav. & Loan Ass'n, 440 N.E.2d 194 (Ill. App. 1939); Mash v. Cutler, 488 N.W.2d 642 (S.D. 1992).

316. Commercial Cotton Co. v. United California Bank, 209 Cal. Rptr. 551, 554 (Ct. App. 1985).

317. *Id.*

ally and in the bank-borrower relationship[318] specifically. Unfortunately, the court gave virtually no guidance whatsoever regarding either what those circumstances would consist of or how we might recognize them when we see them.[319] Therefore, even after the decision in *Copesky*, we are no closer to the elusive holy grail than before, with respect to what elements will consistently and predictably give rise to a fiduciary obligation by virtue of a "special relationship" in either a bank-depositor or a bank-borrower relationship other than when the bank specifically undertakes such responsibility in a written contract.

D. Reasonable Expectations

As one scholar has noted, "[o]ptimal fiduciary rules approximate the bargain that the parties would have reached if the costs of contracting were zero."[320] Thus, there are a range of reasonable and foreseeable expectations that every commercial borrower has regarding the conduct of his lender that are never reduced to writing due to the high transaction costs associated with the effort. An additional reason for not reducing such expectations to writing, is a result of what may be termed, by analogy, to section 2-615 of the Uniform Commercial Code, the "assumptive base" of the parties' contract.

Section 2-615 of the U.C.C. is entitled "Excuse by the Failure of Presupposed Conditions" and provides that a party is excused from performance of an otherwise contractual duty on the basis of the occurrence of a contingency, "the non-occurrence of which was a basic assumption on which the contract was made."[321] Those elements that comprise the "as-

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318. *See* Copesky v. Superior Court, 280 Cal. Rptr. 338, 346 n.12 (Ct. App. 1991). The court said:

> We of course are not saying that a bank may not under special circumstances undertake obligations which bring it into a "special relationship" with a customer . . . We refer in our text, supra, simply to the ordinary bank-depositor relationship (and presumably, although it would be dictum, also to the ordinary bank-borrower relationship).

Id.

319. The court did note, although quite unhelpfully, that "[m]any banks affirmatively offer trust and other specifically fiduciary services." *Id.* Such insight is particulary unhelpful because it merly recognizes the obvious, i.e. that where a bank specifically and by written contract undertakes to offer trust and/or fiduciary services, it will be held to the fiduciary duties of a trustee. Such cases reach litigation only with regard to whether the bank fulfilled its fiduciary reponsibilities in the conduct of performing it duties. They, of course, never raise a question as to whether the bank had a fiduciary reponsibility since that issue is dispositively resolved by the parties' written contract.

320. Fischel, *supra* note 1, at 147 (footnote omitted). As noted earlier, such contracting costs are not zero and the parties to a loan transaction adopt numerous approaches in order to seek the protections afforded by high transaction cost negotiation while trying to reduce the costs of such devices; always mindful, of course, that such costs cannot be reduced to zero.

321. *See* U.C.C. § 2-615(a) (1989). The test for excuse under this section is based on the familiar concept of "commercial impracticability," as opposed to such former characterizations as "impossibility," "frustration of purpose," or "frustration of the venture," in order to "call attention to the commercial character of the criterion." *Id.* cmt. 3. Article 2 of the

sumptive base" of the parties' contract are distinguished from the category consisting of the range of implicit and explicit allocated risks between them. Events and contingencies which constitute the assumptive base in the lender-borrower relationship, like any other, are not reduced to writing because there is such a shared assumption between the parties regarding their non-occurrence that it is mutually regarded as a poor investment in transaction costs to negotiate and memorialize the obvious.

An excellent example of such an obvious "assumptive base" in the lender-borrower relationship (as well as the bank-customer relationship in general) is that the bank will not steal or otherwise misappropriate the money which the depositor entrusts to the bank out of his own pocket, and which the borrower entrusts to the bank out of the proceeds of the loan. Similarly, as seen in the decisions in *M.L. Stewart*,[322] *Pigg*,[323] and their progeny, there is also the assumptive base that the bank will not use the very information which the borrower provides to the bank in confidence in order to secure a loan to compete with the borrower for the same investment opportunity for which the funds are sought. In the cases that have dealt with such conduct by the lender, the plaintiffs have uniformly been successful where they have been able to demonstrate that the information was provided in confidence, and that the bank was unaware of the opportunity but for the information supplied by the borrower.[324] Not surprisingly, the basis of the lender's liability in such cases has been a breach of fiduciary duty.

Code applies only to the "sale of goods." *Id.* § 2-102. However, it can be applied to the lender-borrower relationship from any one or more of three different perspectives: (1) by analogizing the underlying purposes and policies behind the rules pertaining to both types of transactions (The U.C.C. provides that it should be "liberally construed and applied to promote its underlying purposes and policies" § 1-102(1)); or (2) by characterizing their relationship as a "mix" of a transaction involving both goods and services; or (3) by characterizing the borrowered funds in a loan transaction as "goods" in and of themselves. There is particular support for this third alternative in the Code itself. Section 2-105 defines "goods" as "all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid." Moreover, comment one of that section explains that, "[t]he exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment." § 2-105 cmt. 1. Accordingly, to the extent that a commercial loan transaction can be characterized as the "sale of money" as a "commodity" where the interest charges and other fees, are nothing more than the long term financing costs of such a sale, such a transaction falls squarely within the Code's definition of a transaction in "goods."

322. For a discussion of M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685 (Sup. Ct. 1924), see *supra* notes 44-64 and accompanying text.

323. Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1971). For a brief discussion of this case, see *supra* note 162.

324. *See Pigg*, 549 S.W.2d at 601. *See also M.L. Stewart & Co.*, 207 N.Y.S. at 692 (stating that "if a person applies for a loan, and in connection with that application discloses his purpose to avail of a bargain which he had not as yet closed by contract, and of which the lender had not previously heard, the courts . . . would afford some form of adequate relief").

However, the range of confidential information a borrower provides to a lender from which the lender could potentially profit is not limited simply to investment opportunities. Typically, a borrower or prospective borrower will provide a lender with a great deal of confidential, personal, and even proprietary information, both in meeting the lender's demands for information upon which to determine approval of the loan in the first instance, and subsequent to that approval, on a periodic basis during the process of servicing the loan in order to monitor the borrower's performance with the terms of the loan agreement. As seen in the case of *Steelvest*,[325] a lender may acquire and breach a fiduciary duty to its borrower, when it uses confidential information obtained from the borrower, to which it would otherwise not have access, in order to make a lending decision regarding another borrower, especially where the second borrower is, or will be in direct competition with the first borrower.[326]

That such conduct by the lender is violative of the parties' assumptive base can hardly be doubted. For example, suppose that at the time of the loan application the lender provided the following written disclaimer:

> We hereby make no representation or warranty that any funds deposited or otherwise entrusted to the Bank, whether belonging to the borrower or direct loan proceeds hereunder, will not be stolen or otherwise misappropriated by the Bank, and further, that any information supplied by the borrower, either pursuant to this application or subsequent thereto, which may be of a confidential, personal, or proprietary nature, will not be used by the Bank either to compete directly against the borrower for an investment opportunity or to provide funds to a competitor of the borrower, which funds might otherwise not have been provided. Borrower hereby consents to and waives any and all claims against the Bank on the basis of any of the aforesaid conduct by the Bank.

If this, or any similar type of language appeared in any bank's proposed loan agreement, that bank would be hard pressed to find any borrowers willing to accept such outrageous terms.

Accordingly, the absence of this type of language from the parties' written agreement does not indicate that they have agreed to allow such conduct by the bank, but rather it suggests that it is so far beyond both parties' reasonable and foreseeable expectations, that the assumptive base of their contract includes an expectation that such conduct is prohibited. At the very least, it is a part of the borrower's assumptive base. A reasonable lender is either actually aware of this expectation or reasonably should be, and thus is chargeable with either actual or constructive knowledge of it. It would, therefore, be both anomalous and disingenuous for a lender to argue that such conduct was within its permissible range of action, merely because it was not expressly forbidden by the parties' written agreement.

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325. Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 N.W.2d 476, 486 (Ky. 1991).
326. *Id.* at 485.

Similarly, part of the assumptive base in the lender-borrower relationship includes the concept of competency and mutual good faith. In fact, section 2-615 of the U.C.C. specifically refers to the concept of good faith as an overall interpretive tool to be employed in resolving claims of "presupposed conditions."[327] Accordingly, borrowers are justified in their expectation that commercial banks that invite their loan business are implicitly representing that they are competent to underwrite, process and service such business, that they will employ such expertise in the conduct of their business, and that they will, at the very least, attempt to respond honestly when problems arise regarding the bank's conduct. It follows from this that when problems do arise the bank will not "unreasonably and even in bad faith, deny liability . . . or [knowingly] interpose spurious defenses."[328]

A borrower's vulnerability to coercion and opportunism by a lender in the process of negotiating a loan agreement may be a function of the borrower's sophistication, experience and access to independent legal counsel, and thus an inherent risk of contracting. However, the same cannot be said regarding the processing and servicing phases of their relationship. During this phase, a borrower's vulnerability to coercive, opportunistic and incompetent behavior by its lender is not an aspect of a special relationship between them, nor of the power and resources of the borrower, but rather, it is an inherent aspect of the lender-borrower relationship itself.

The vulnerability of the borrower is a *normative* function of the lender-borrower relationship, not a special one. It should accrue regardless of the borrower's power, sophistication, or access to independent counsel. No borrower can efficiently monitor a lender's competency, good faith, or opportunism in the processing and servicing of its loan (or deposit account for that matter). As a result, any incompetence, bad faith, or opportunism by the lender only becomes apparent after the fact, once the damage is done. Such damage is all too frequently unamenable to valuation in terms of money damages. Some examples include the usurpation of a corporate opportunity and the funding of a direct market competitor on the basis of confidentially supplied and otherwise unavailable

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327. *See* U.C.C. § 2-615 cmts. 5-6 (1989). "The flexible adjustment machinery of this Article provides the solution under the provision on the obligation of good faith. . . ." § 2-615 cmt. 5.

> In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith . . . and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

§ 2-615 cmt. 6. Of course, good faith in this context is defined under the Code in section 2-103, as between merchants, as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." § 2-103(1)(b).

328. Copesky v. Superior Court, 280 Cal. Rptr. 338, 348 (Ct. App. 1991).

information.[329]

One effective protection that a borrower has from this type of harmful conduct by the lender is deterrence. The lender must be deterred from engaging in this type of behavior either by a bonding mechanism or by an independent duty imposed statutorily or judicially. The borrower cannot easily restrain the lender in this regard on his own, and ultimately the lender must either restrain himself or be restrained by the force of law. As we have seen in *Copesky*, the prospect of simple contract damages is not enough to effect such self-restraint by banks.[330] Rather, the award of such damages only encourages a more diligent calculation of the economic efficiency of particular opportunistic conduct contemplated by lenders, since they know that ordinary tort and even punitive damages may no longer be available to the borrower. Loss of reputation is similarly an ineffective deterrent, since as one scholar has noted, "actions by the lender will often prove ambiguous in their justification. It will frequently be difficult, in other words, for future borrowers to draw inferences from [the] lender's past actions."[331]

Finally, once the lender's misbehavior is revealed, even the prospect of the injured borrower seeking alternative sources of credit may not be an effective deterrent. This is true because the costs to the borrower of negotiating a new loan arrangement with a substitute source of funds can be quite high, both in terms of direct transaction costs and, more indirectly, the lost opportunity costs suffered by the borrower during the substitution process. In addition, to the extent that the lender's misbehavior had a substantial negative economic impact on the borrower and/or its competitive position in the market, the borrower may be a less attractive loan applicant for other potential lenders. As a consequence, not only does this result in a diminution of deterrence to lender misbehavior, but the net result is actually an increase in the lender's incentives to engage in or at least not to actively refrain from such misbehavior, because the lender is aware of the borrower's limited remedial alternatives.[332] Ironically, the very courts to which injured borrowers turn for protection from lender abuse and over-reaching, not only frequently fail to afford them

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329. Even the disgorgement of profits is problematic in this regard, because there is no way to precisely determine what profits, if any, would have been earned in the hands of the borrower if he, rather than the lender, had been managing the opportunity, or if he had been free of that particular market competitor during the precise period in question.

330. *Copesky*, 280 Cal. Rptr. at 348.

331. Fischel, *supra* note 1, at 139.

332. *See id.* at 139. The author points out that in theory "the probability of opportunistic behavior by lenders is increased by the presence of the very monitoring and bonding mechanisms designed to limit debtor misbehavior." *Id.* In addition the author highlights the difficulty which may confront a borrower seeking substitute sources of funds

> when the relationship between the initial lender and the borrower has become highly specialized over time. If the lender has acquired a great deal of costly information about the particular borrower and its prospects, it can loan on more advantageous terms than lenders who are less informed. The advantage of the first lender will be even greater if the borrower is faced with time immediacy.

Id.

any protection, but, in the process, actually make the situation worse by encouraging rather than discouraging lender misbehavior.

IV. Suggestions for Reform

A. *The Public Welfare*

One of the primary bases for the decision in *Commercial Cotton* was its favorable comparison between the insurance industry, where the new tort of bad faith breach of the implied covenant of good faith and fair dealing was first created and the banking industry.[333] In comparing the two industries, the *Commercial Cotton* court found that they "have much in common, both being highly regulated industries performing vital public services substantially affecting the public welfare."[334] In overturning that case, the *Copesky* court disagreed that the banking industry substantially affected the public welfare, stating that it found nothing "in the status of banking as an industry"[335] sufficiently important or substantial that it should even "have an effect upon the issue before us."[336]

In reaching this rather striking conclusion, the *Copesky* court did not engage in any analytical discussion concerning why the insurance industry substantially affected the public welfare in a way that the banking industry did not. In fact, the court did not even identify any factors or elements by which future courts could determine whether a particular industry met the standard of "substantially affecting the public interest." *Copesky* simply said that the banking industry did not.[337] Ironically, while *Copesky* criticized the *Commercial Cotton* decision for its lack of citation or other authority to support its invention of the "quasi-fiduciary" standard, the only authority which *Copesky* cited in support of its rejection of *Commercial Cotton*'s view of the importance of the banking industry to the public welfare was a student comment in a law review that found the singling out of the banking industry in this regard to be "absurd," and concluded that it was no more "affected with the public interest" than the garbage collection industry.[338]

Interestingly, *Commercial Cotton* did not afford the banking industry the status of "quasi-fiduciary" merely on the basis of it "affecting the public interest." Rather, the court said that banking, like insurance, "*substantially* affect[ed] the public interest."[339] Neither the student comment nor *Copesky* dealt with what, if any, enlargement of meaning was meant or occasioned by the qualification of *substantiality*. However, it strikes this author as "absurd" to dismiss the importance of the banking indus-

333. Commercial Cotton Co. v. United California Bank, 209 Cal. Rptr. 551, 554 (Ct. App. 1985).

334. *Id.*

335. *Copesky*, 280 Cal. Rptr. at 347.

336. *Id.*

337. *Id.*

338. *Id.* (citing Curtis, *supra* note 245, at 816-17).

339. *Commercial Cotton*, 209 Cal. Rptr. at 554 (emphasis added).

try to the public welfare so casually and superficially. Surely, there is a substantiality in this regard which banking does not share with garbage collection!

Had the *Copesky* court delved into the subject more deeply, it might have noted that although the list of industries that merely and generally affect the public welfare might be endless, it could be said that there is a clear hierarchy among them and that distinctions can and should be made as a matter of public policy. As evidence of the importance of the banking industry to the public welfare, Congress has placed the full faith and credit of the United States government behind the public's deposits (up to $100,000 per account) in the form of FDIC insurance. Moreover, through federal truth in lending laws, Congress has again intervened into the banking industry and required that a full and rather detailed set of financial disclosures must be made in connection with every loan transaction.[340] These distinctive features of the banking industry distinguish it from many others which affect the public welfare in terms of substantiality, and arguably place it somewhere at or near the top of the hierarchical list. Notably, even the insurance industry, which *Copesky* acknowledges to be at the top of that list,[341] does not have anything like FDIC insurance and therefore the full faith and credit of the federal government behind it.

Accordingly, this author suggests that *Commercial Cotton* was correct in finding that there is something distinctive or "special" about the bank-borrower and the bank-depositor relationship that justifies, in the interest of public welfare, affording the public protections that more closely resemble the insurance industry than the garbage collection industry. The decision in *Copesky* which criticized and overruled *Commercial Cotton* was simply wrong and short-sighted. It failed to accurately consider the vital public functions which the banking industry performs, its distinctive importance to the public welfare, and the peculiar vulnerability of borrowers and depositors to abuse through opportunistic behavior and misbehavior by their bankers.

Accordingly, it does not appear "absurd" to this author in the least to suggest that there is indeed something very special about the banking industry that warrants special treatment. This is not to suggest, in line with the now discredited decision in *Commercial Cotton*, that the entire industry should be characterized as having a fiduciary or even a quasi-fiduciary relationship with its customers. There is a middle ground that goes substantially beyond where *Copesky* left us but not as far as *Commercial Cotton* would take us.

340. *See, e.g.*, 15 U.S.C. §§ 1601-93 (1988).
341. *Copesky*, 280 Cal. Rptr. at 343.

B. *Bifurcation of Negotiation and Processing*

The decision in *Stone v. Davis*[342] suggests a reasonable alternative to the polar extremes posed by *Copesky* or *Commercial Cotton*. In *Stone*, the court drew a sharp distinction, with substantial analytical support, between the negotiation process by which the terms and conditions of a loan or deposit agreement are reached, and the servicing of that agreement by the bank.[343] This is a sound and reasonable bifurcation that has much to offer. A careful review of lender liability claims on the basis of fiduciary duty reveals that in most of them the borrowers do not allege that the lender owed them such a duty in the initial negotiation of their loan agreements. Rather, almost all of their claims relate to conduct by the lender in the course of what could accurately be characterized as either the servicing or processing stages of the loan, and in terms of how their written agreement should be interpreted, enforced and modified during the course of such servicing.[344]

Therefore, a management regime that recognized this distinction between the negotiation and servicing or processing phases would not upset the traditional view of the arm's-length relationship between a bank and its customer, whether borrower or depositor. Rather, it would merely extend the already existing law by virtue of the federal government's imposition of disclosure requirements on banks, which now tempers that relationship in rational and fair ways. This system could be improved and clarified by positive state and federal legislation expressly providing that in the servicing of loans and customer deposits, banks are in a normative fiduciary relationship with their customers, which requires them to use the utmost "candor, rectitude, care, loyalty and good faith—in fact to treat the [customer] as well as the [bank] would treat itself."[345] Any breach of this duty should result, if not in tort damages per se, at the very minimum, in a trebling of such damages or some similar remedy, which serves not only as compensation, but also serves the goal of deterring banks from engaging in such behavior and punishing them when they do.[346]

It has been suggested that to impose such a fiduciary requirement upon banks would be totally inappropriate, as banks and their borrowers are adverse in the negotiating process.[347] Although this may be true while

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342. 419 N.E.2d 1094 (Ohio), *cert. denied* 454 U.S. 1081 (1981).

343. *Id.* at 1098.

344. *See, e.g.*, Blon v. Bank One, 519 N.E.2d 363 (Ohio 1988); Logsdon v. National City Bank, 601 N.E.2d 262 (Ohio C.P. 1991).

345. Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992) (describing the duties of a fiduciary in terms of principal and agent) (citation omitted).

346. Under the holding in *Copesky*, banks would be free to act "unreasonably, and even in bad faith, den[y] liability on a contract or interpose spurious defenses." *Copesky*, 280 Cal. Rptr. at 348-49. A customer injured by such "lying" and unreasonable behavior would be limited to simple contract damages. Consequently, not only would the customer not be made whole, but banks facing such a limited range of damages would not be deterred from acting in a manner harmful to the public interests at stake.

347. *See* Weinberger v. Kendrick, 698 F.2d 61, 79 (2d Cir. 1982), *cert. denied* 464 U.S.

the parties are still at the bargaining table, there is little analytical reason to continue this type of characterization once its predicate falls away. Once the bargaining is over, the agreement has been struck and the parties are in the performance stage of their agreement, which consists of the bank's servicing and processing of the agreement.

It strikes me as even more appropriate to suggest that an industry which expressly invites its customers to trust it in ways that few others do[348] should then be entitled to disclaim any responsibility for being "trustworthy" unless it is specifically bargained for and included in the written contract with their customer. Such trustworthiness is an assumptive base of the bank-borrower and bank-depositor relationship, especially in the servicing or processing phase of that relationship. As such, the rebuttable presumption against a bank having fiduciary duties should be reversed. Rather than requiring evidence of a conscious assumption of such duties by the bank, the burden should be on the bank to demonstrate that, to the extent permitted by public policy, its customer specifically, freely and knowingly contracted out of this otherwise assumptive relationship. Absent such a demonstration, the bank should be deemed to have a fiduciary relationship with its borrowers and depositors which is limited to the servicing and processing phase of their relationship. As the court in *M.L. Stewart* said in the oft cited and by now famous quote, "banks present a constant invitation to intending borrowers [to trust] and thus subject themselves to whatever implication or obligation is to be drawn from that fact."[349]

CONCLUSION

In the final analysis, it can hardly be doubted, notwithstanding the decision in *Copesky*, that the banking industry "perform[s] vital public services substantially affecting the public welfare"[350] in ways that few other industries do. To the extent that individual banks suffer substantial losses by virtue of federal deposit insurance, each and every taxpayer bears the ultimate burden of those losses. The savings and loan crisis is a classic example of society paying for banking mistakes. The public's trust in that industry, its willingness to participate in banking activities, to save and invest money, to make deposits, and to borrow money to start or expand business enterprises, is vitally important to the public welfare and ultimately, to the national interest.

Although not susceptible to precise empirical verification, it is logical to conclude that one of the primary factors which has fueled the recent explosion of borrower lawsuits on the basis of a breach of fiduciary duty

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818 (1983).

348. Interestingly, many banks even have the word "Trust" in their names, e.g., First Bank and Trust, X,Y,Z Savings and Trust Co., etc., thereby furthering in the public's mind the perception that "trust" is an integral part of the services offered by such corporations.

349. M.L. Stewart & Co. v. Marcus, 207 N.Y.S. 685, 692 (Sup. Ct. 1924).

350. Commercial Cotton Co. v. United California Bank, 209 Cal. Rptr. 551, 554 (Ct. App. 1985).

is a loss and perceived abuse of that trust which banks so actively solicit and borrowers so willingly give them. As a consequence, banks have suffered enormous costs in defending such litigation and in satisfying the resulting judgments. No doubt these losses have been passed on to borrowers and depositors in the form of increased costs and a reduced willingness to lend. The public has likewise suffered losses on a similar scale, brought about by a chilling effect on borrowing caused by a reduction in the availability of funds and the increase in the costs associated with borrowing. Judicial interpretations which severely restrict the recognition of a fiduciary relationship between a borrower or depositor and its lender or bank, where all of the elements of trust and the abuse of that trust are present, tend to undercut the ability or willingness of the public to trust in the banking industry or participate in it. Such decisions can have significantly damaging and far-reaching effects in terms of the public's willingness to expose itself and its fortunes to such risks, and ought to be approached with a caution commensurate with the stakes involved.

Similarly, such interpretations also tend to undercut the ability of the parties to reduce their transaction costs by creating mutually beneficial monitoring and bonding mechanisms, thereby actually increasing the costs of such transactions. Consequently, they should be undertaken only under the most extreme circumstances and with a full appreciation of their potentially damaging and counterproductive implications.

Perhaps more than any other industry, trust is the "coin of the realm" in the banking industry. As noted in the court's decision in *Commercial Cotton*, "except for state or federal regulatory oversight,[351] both depositors and borrowers (at least with respect to the servicing or processing aspects) are "totally dependent on the banking institution to which it entrusts . . . and depend on the bank's honesty and expertise to protect them."[352] Banks invite both borrowers and depositors to trust them, and they receive that trust from both in a myriad of ways. It is an inherent part of their relationship. As such, the lives, fortunes and futures of countless thousands are placed in the hands of the nation's banks on a daily basis. The ultimate price of that trust is quite simply to be *"trustworthy."* By virtue of its nature, history and development, the fiduciary obligation is uniquely capable of ensuring such trustworthiness where it is not otherwise voluntarily provided.

Bifurcating the lender-borrower (and bank-depositor) relationship between the negotiation and the servicing stages, and recognizing a fiduciary obligation in the latter and an arm's-length relationship in the former, would constitute a modest but helpful beginning in insuring the necessary trustworthiness of lenders and banks where it otherwise might not exist. In addition, such recognition would balance the interests of both the banking industry and the public while affecting only a minimal disruption of violence to the traditional relationship between the parties.

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351. *Id.*
352. *Id.*

Finally, such a system would recognize the reasonable and foreseeable contemporary expectations and values of the modern depositor and borrower, thereby increasing both their trust in the banking industry and their willingness to participate and expose themselves to its inherent risks. As a consequence, the banking industry would receive the benefit of increased soundness and participation from the public. In turn, the public would receive the benefit of increased safety and freedom from the costly abuse of their trust and coercive opportunism and misbehavior by their bankers and lenders.