Fiduciary Duties and Conflicts of Interest: An Inter-Disciplinary Approach

Abstract

One of the foremost problems of fiduciary law theory is the imprecise understanding of what a situation of conflict of interest involves. The contemporary legal literature on fiduciary duties is premised on the dual assumption that, on the one hand, humans are inclined to act self-interestedly and, on the other hand, they are too weak to resist the urge of acting opportunistically while administering another’s affairs. Although these assumptions may be true in many cases of breach of fiduciary duties, they do not suffice to explain why fiduciary duties are imposed in situations where the fiduciary’s honesty cannot be questioned. The emerging inter-disciplinary theory of conflicts of interest shows that interests encumber judgment in unpredictable ways, and despite the decision-maker’s honest efforts to keep them aside. This theory offers a more persuasive justification for the peculiar strictness of fiduciary duties.

Keywords: fiduciary duties; decision theory; conflict of interest; decision-making process; bias

1. Introduction

Fiduciary duties wield on common law scholars “something of the fascination… that the search for the Holy Grail had for the knights of Antiquity.”¹ Like the quest for the Holy Grail, the search for the nature, content and justification of fiduciary duties is complicated by the fact that common law scholars disagree as to what exactly fiduciary duties are.² When fiduciary duties arise, what legal requirements they impose, and what is the justification for their strictness are controversial questions. While the debates on the first two issues share some core common ground, the search for a satisfactory theoretical justification for the existence and peculiar strictness of fiduciary duties continues unabated.

² Although these issues are increasingly relevant for civil law and mixed jurisdictions as well, this paper focuses on the common law tradition. The core insights on the content and justification of fiduciary duties, however, are not confined to any specific legal tradition.
This paper aims to advance the understanding of the purpose of fiduciary duties by bringing into law insights from the emerging cross-disciplinary theory of conflicts of interest. Building on insights from cognitive psychology, behavioural economics and philosophy, this emerging theory defines a conflict of interest as the situation where a person, who has a duty to exercise judgment for the benefit of another, has an interest that tends to interfere with the proper exercise of his judgment. Conflict of interest situations affect the reliability of the decision-maker’s judgment in ways that cannot be measured or corrected adequately. This theory offers a very sound explanation for the peculiar harshness of fiduciary duties. The main reason for these strict duties is not preventing the temptation to steal or shirk, or disciplining the market, as the main current justifications hold, but preventing self-interest or other-regarding interests from interfering with the proper exercise of fiduciary judgment.

The paper proceeds as follows. Section 2 outlines the legal framework of fiduciary duties. It reviews the main themes regarding the incidence of fiduciary duties, their content and the main theoretical justifications of their strictness. Section 3 discusses the emerging inter-disciplinary theory of conflicts of interest. Section 4 addresses the relevance of this theory for the law of fiduciary duties. Section 5 concludes.

2. Fiduciary duties: the law

2.1 The incidence and content of fiduciary duties

Fiduciary duties arise in fiduciary relations. But which relations are viewed in law as having a fiduciary character? In other words, when is a person bound by fiduciary duties? Who is a fiduciary?

The traditional view of fiduciary relations is based on the idea that one person holds or controls property that in Equity belongs to another. Traditionally, only a limited number of relations were recognised by courts as fiduciary. Established fiduciary positions included trustees, guardians, executors, agents, attorneys, corporate directors or officers, and partners. The traditional narrow approach has been gradually loosened. Today it is generally agreed that fiduciary duties are not restricted to powers over another’s property. The list of fiduciary relations is not closed.

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The recognition of the open-ended nature of the family of fiduciary relations has created the need to identify the core elements that trigger the application of fiduciary duties in new relations. The problem of identifying the core elements of a fiduciary relation has been amply debated and, until recently, there was no sign of progress in sight. Recent jurisprudential developments, however, have focused the analysis of the core elements of fiduciary relations on two elements: undertaking to act in another’s interests and power or discretion to affect another’s interests. The requirement of undertaking to act for another signifies that fiduciary duties are triggered voluntarily. They are enforceable only against those persons who undertook to do something for the benefit of another. As regards the second element, the existence of a discretionary power to affect the legal or practical interests of another is a fundamental characteristic of fiduciary relations. The feature that qualifies the ‘power’ requirement of a fiduciary relation is discretion. A fiduciary has discretionary power in the sense that he has authority to decide how to promote the best interests of the beneficiary, and not simply authority to decide whether to act or not in a pre-defined manner. In other words, the requirement of power is best understood as decision-making authority. The elements of undertaking and discretionary power show that fiduciary duties are enforced because the fiduciary has agreed to do a certain task or fulfil a certain position that requires exercise of judgment for the benefit of another.

What do fiduciary duties require from the decision-maker? The content of fiduciary duties is a topic that has generated decades of debates and theories. Three main currents of thought have emerged. In a narrow approach, the fiduciary duties are equated with the specific proscriptive (or negative) duties imposed on fiduciaries. In a broader view, the

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8 Robert Austin articulated these uncertainties in a very concise and evocative manner: “Is the hallmark of a fiduciary relationship simply that one party owes a duty of loyalty to another, or are there separate fiduciary duties of care, disclosure, and (where relevant) strict adherence to the charter (such as an instrument or memorandum or articles of association) which constitutes the relationship? What precisely do we mean by ‘loyalty’? Does it extend beyond the narrowly defined conflict and profit rules to encompass positive duties to act in the interest of the principal and in good faith?” (Robert P. Austin, “Moulding the Content of Fiduciary Duties” in A.J. Oakley, ed., Trends in Contemporary Trust Law (Oxford: Oxford University Press, 1996) 153 at 153).

fiduciary duties comprise the proscriptive duties and a set of prescriptive (or positive) duties. In a third view, the fiduciary duties group is formed of the proscriptive duties and a core duty.

The narrow approach is the dominant understanding of the content of fiduciary duties. This view is generally formulated as follows: fiduciary duties are proscriptive; they do not tell fiduciaries what to do, only what not to do, in discharging their other duties. The proscriptive duties are commonly divided into four fiduciary rules: the no-profit rule, the no-conflict rule, the self-dealing rule and the fair dealing rule.

The no-profit rule forbids a fiduciary from retaining any unauthorised benefit acquired by virtue of his fiduciary position. The no-conflict rule states that a fiduciary is not allowed to place himself in a position where his personal interest, or interest in another fiduciary capacity, conflicts or possibly may conflict with his duty. The self-dealing rule renders voidable, at the beneficiary’s will, transactions by a fiduciary, in his personal capacity, with property under his administration, irrespective of the honesty of the transaction. The fair dealing rule renders voidable the purchase by a fiduciary of the beneficiary’s interest, unless the fiduciary demonstrates that the transaction is entirely fair and honest and that the beneficiary gave his informed consent.

Fiduciary law scholars have engaged in long debates over the autonomy of the no-profit, self-dealing and fair dealing rules with respect to the no-conflict rule. A position that has strong doctrinal support is that the former three rules are specific instances of the latter rule.

Regardless of the way in which they are grouped (from a single rule to four separate rules) it is uncontested that a breach of any of these four rules is a breach of fiduciary duty.

10 Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co, 1977). *Simonetti v. Plenge*, 224 A.D.2d 1008 at 1010 (4th Dept. 1996): “General partners are in a fiduciary relation to all limited partners… This [fiduciary] duty… is one of candor, fairness, good faith, honesty, loyalty and unselfishness.”


12 Since this paper is concerned with the rules against conflicts of interest, which are part of fiduciary duties in any of the three approaches, only the narrow approach will be discussed.


14 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134.

15 A notable exception to this rule is the entire fairness standard of review applicable in the US corporate law (especially Delaware).

16 *Tito v. Waddell (No. 2)* [1977] Ch. 106 at 241

Furthermore, it is universally acknowledged that these rules are very strict. The peculiar strictness of the proscriptive duties has been the leitmotif of fiduciary law since the earliest reported cases.\(^{18}\) Throughout the centuries, the courts have developed several facets to this specific severity of the proscriptive duties.

One facet is the reprehensibility of the possibility of self-interested conduct. Fiduciaries have been held liable for breach of the no-conflict rule not only in case of an actual conflict between interest and duty, but also when there was a reasonable possibility of such a conflict.\(^{19}\) In some cases, it has been argued that even the remote possibility of conflict is sufficient to find a breach.\(^{20}\) It is generally agreed, though, that, for a potential conflict of interest to exist, there must be a reasonable possibility of such conflict, not a mere appearance of conflict.\(^{21}\)

Liability for breach of the proscriptive rules is very strict, also in the sense that it does not depend on the fiduciary’s good faith or actual motives, on the fact that the beneficiary has suffered no loss or has obtained a benefit following the conflicted transaction, or on the fact that the opportunity that the fiduciary has taken for himself was no longer available to the beneficiary. For example, if a company director injects equity in the company to allow it to finance a business opportunity, and subsequently sells his shares at a profit, he breaches the no-profit rule even if he was acting in good faith in what he believed to be in the best interests of the company.

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\(^{18}\) In the first landmark case, *Keech v. Sandford*, the strictness of the no-profit rule appears to be already well-established. Lord Keeper King famously argued for the preservation of the severity of this rule: “This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed…” (*Keech v. Sandford* (1726) Sel Cas Ch 61 at 63, emphasis added). Half a century later, in 1788, in Lord Thurlow affirmed that the no-profit rule binding on trustees is the most “sacred rule” of the Court of Chancery: “Now there is no one more sacred rule of a Court of Equity than that a trustee cannot so execute a trust as to have the least benefit from it himself.” (*Forbes v. Ross* (1788) 2 Cox 112 at 116, emphasis added). See also *Parker v. McKenna* (1874) LR 10 Ch App 96 at 124-125 per Lord James, emphasis added: “[W]e should concur in laying down again and again the general principle that in this Court no agent in the course of his agency… can be allowed to make any profit without the knowledge and consent of his principal; that that rule is an inflexible rule, and must be applied inexorably by this Court...” *Bray v. Ford*, [1896] A.C. 44 at 51, emphasis added: “It is an inflexible rule of a Court of Equity that person in a fiduciary position... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict.” *Meinhard v. Salomon*, 294 N.Y. 458 at 464 (1928) per Cardozo J., emphasis added: “Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. And to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions.”

\(^{19}\) *Aberdeen Railway Co v. Blakie Brothers* (1854) 1 Macq 461 at 471-472, per Cranworth LC; *Bhullar v. Bhullar* [2003] EWCA Civ 424, per Parker LJ; *Item Software (UK) Ltd. v. Fassihai* [2004] EWCA Civ 1244, per Arden LJ.

\(^{20}\) *Boardman v. Phipps* [1967] 2 AC 46 at 111 per Hodson LJ.

of the company. 22 In another example, a director caused the company to purchase goods from a partnership in which he was a partner. The transaction breached of the no-conflict rule, even if it was entirely fair to the company and the director was in good faith.23

Yet another aspect of the strictness of the proscriptive duties is the fact that the purchase by the fiduciary of property under his administration is voidable, even if the transaction appears to be entirely honest and fair. For instance, if a trustee who is charged with selling trust property buys such property for himself, he is in breach of the no-conflict rule, even if the transaction is at arms’ length and full value is given. 24

The peculiar strictness of these duties is difficult to explain. Why is a fiduciary in breach of duty although the beneficiary suffered no loss, or even befitted from the conflicted transaction? Why is fiduciary’s good faith irrelevant? Why are courts not even prepared to admit evidence that no harm was caused? The most frequent justifications of the strict fiduciary duties are the need to protect peculiarly vulnerable persons against abuse of their trust and confidence in others, and the need to discourage even the temptation of selfish behaviour by fiduciaries. As it will be discussed in the following section, these explanations are unconvincing and inadequate for the private law setting in which most fiduciary duties arise.

2.2 The main justifications of fiduciary duties and their shortcomings

Too frequently the discussion of the nature and function of fiduciary duties invokes the biblical adage that no man can serve two masters.25 Applied in the context of fiduciary relations, this maxim is interpreted as stating simply that a person in a fiduciary position, who is charged to look after the interests of another, is not allowed to be in a position where he

22 Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378; [1967] 2 AC 134 at 144 per Lord Russell, emphasis added: “The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as to whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well intended, cannot escape the risk of being called upon to account.”

23 Aberdeen Railway Co v Blakie Brothers (1854) 1 Macq 461.

24 Robertson v Robertson [1924] NZLR 552 at 553.

25 “No one can serve two masters. Either he will hate the one and love the other, or he will be devoted to the one and despise the other.” (Matthew 6:24). Justice Harlan Stone, for instance, observed that “[t]he fiduciary principle [is] the precept as old as Holy Writ, that a man cannot serve two masters.” (Harlan F. Stone, “The Public Influence of the Bar” (1935) 48 Harv. L. Rev. 1 at 8); See also York Buildings Company v Mackenzie (1795) 8 Brown PC 42 at 63: “The ground on which this disability or disqualification rests, is no other than the principle which dictates that a person cannot be both judge and party. No man can serve two masters.”
may be tempted to act in his own interest rather than in the interests of the beneficiary. In this superficial approach, the idea of ‘conflict of interest’ is equated with ‘conflicting interests’, that is a conflict between the fiduciary’s personal interests and the interests of the beneficiary.

The conflicting interests approach justifies the existence of the proscriptive duties based on the inequality of footing existing between the parties to a fiduciary relation. The fiduciary has a privileged position, resulting from factors such as power or discretion over the beneficiary’s interests, direct control of beneficiary’s assets, or superior knowledge and skill. The beneficiary is placed on an inferior position, in the sense of being exposed to harm caused by the fiduciary. His vulnerability stems from various factors, such as inherent incapacity to protect his interests, inability to monitor the fiduciary, or reasonable expectation and reliance that the fiduciary will not abuse his position. This inequality of footing gives the fiduciary enhanced opportunities to act selfishly, and thus creates a conflict between the fiduciary’s self-regarding interests and the beneficiary’s interests, as circumscribed by the limits of their fiduciary relation. Based on the idea of the conflict between the interests of the parties to a fiduciary relation, several main explanations have developed for the strictness of the proscriptive duties.

2.2.1 The deterrence argument

Deterrence is one of the most frequently invoked policy explanations for the strictness of the proscriptive duties, and, and the same time, one of the weakest arguments. The very strict fiduciary duties are meant to act as a “sledge-hammer… designed to eliminate incentives for opportunistic manipulation…”26 Only indiscriminate punishment of actual and potential situations of conflict of interest can annihilate fiduciaries’ incentives to take their chances and pursue unauthorized benefits.27 Moreover, the role of fiduciary law is not to achieve a balance between the parties to a fiduciary relation, but to set an example and to encourage good behaviour, by insisting that nothing short of exemplary propriety on the fiduciaries’ part will is allowed.28 Some authors have gone as far as claiming that fiduciary

27 Ibid.
28 Gary Watt, Trusts and Equity, 2nd ed. (New York: Oxford University Press, 2006) 337-338, emphasis added: “[The fiduciary duty] is not concerned to achieve fairness between the trustee and the beneficiaries of the trust or between a fiduciary and his principal. On the contrary, it is a rule of public policy that is strictly applied against trustees in order to set an example and to encourage good behavior in all who hold positions of trust… Insistence on exemplary fiduciary propriety encourages other persons in positions of trust to fulfil requirements of their office.”
law is akin to the criminal law of theft or embezzlement, and should follow the latter’s underlying policy.29

The deterrence theory suffers from several major flaws. From a historical point of view, it is open to debate whether a policy of disciplining fiduciaries was the main reason for the introduction of these strict rules.30 The landmark fiduciary law cases of the nineteenth century showed little or no concern for the reason why these rules exist. They focused, instead, on expanding them to persons in trust-like positions, and on restating constantly the need to maintain their strictness. Moreover, the deterrence explanation of fiduciary duties is built on an erroneous view of the fiduciary’s role. Refraining from stealing, embezzling or converting another’s property is not a duty that one has by virtue of occupying a fiduciary position; it is a general duty binding on all legal actors. The enhanced probability for such acts to occur (the ‘temptation of self-interest’) in the case of persons in a fiduciary position is not sufficient to turn the ‘don’t misappropriate’ requirement into a fiduciary duty.

Furthermore, the deterrence argument does not explain why no inquiry is allowed into the fiduciary’s motives or good faith, once a reasonable possibility of conflict has been found to exist. If the law aims to deter fiduciaries from improperly using their powers, punishing an innocent fiduciary is not good deterrence. The ‘deterrence at all costs’ approach would in fact produce the opposite results. Punishing the potentially innocent would signal to the guilty that what matters is not the actual guilt or innocence, but how their actions appear to the outside world.31

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29 Tamar Frankel, “Fiduciary Duties as Default Rules” (1995) 74 Oregon Law Review 1209 at 1223-1225, footnotes omitted: “[T]he main purpose of fiduciary law is to reduce entrustors’ risk from embezzlement of their entrusted property or interests, and to reduce the costs of monitoring fiduciaries... Because... fiduciary law is akin to the criminal law of embezzlement and the tort of conversion, the dividing line between mandatory and default rules, as well as the treatment and policy underlying default rules in embezzlement and conversion, could help guide the treatment of fiduciary rules.”

20 Frank H. Easterbrook and Daniel R. Fischel, The Economic Structure of Corporate Law (Harvard: Harvard University Press, 1996) 92-104: “Fiduciary principles contain antitheft directives, constraints on conflict of interest, and other restrictions on the ability of managers to line their own pockets at the expense of investors... Managers must prefer investors’ interests to their own in the event of conflict. That is the core of the duty of loyalty.” For an innovative critique of the contractarian theory of fiduciary duties see Gregory S. Alexander, “A Cognitive Theory of Fiduciary Relationships” (2000) 85 Cornell Law Review 767 (arguing that courts apply different cognitive processes when analysing breaches of fiduciary duty and, respectively, breaches of contract).”

30 The elusive reporting of Keech v. Sandford, the first and foremost landmark case of fiduciary law, suggests that Lord Keeper King invoked the deterrence theme not as the rationale for the existence of the strict proscriptive duties, but as an important reason for maintaining them: “This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed.” (Keech v. Sandford (1726) Sel Cas Ch 61). This statement can be interpreted as demonstrating that, by the time of this decision, the strict prohibition of self-interest for persons in a position of trust was an established and rigid rule.

2.2.2 The vulnerability argument

Another justification of the strict fiduciary duties, based on the ‘conflicting interests’ approach, is the need to protect beneficiaries of fiduciary relations, which are peculiarly vulnerable to abuse. The strict proscriptive fiduciary duties are part of the law’s response to “the plight of vulnerable people in power-dependency relationships.”32 In this view, vulnerability is the single indispensable requirement for the imposition of a fiduciary duty.33

The vulnerability theory is among the weakest explanations of the proscriptive duties. The attempts to understand fiduciary relations based on vulnerability have been criticised as either too broad or too narrow. On the one hand, some theories are too broad because they encompass situations of vulnerability that form the main focus of other doctrines. The protection of the weak, vulnerable or disadvantaged could be seen as a remote objective of fiduciary law, but it is too general to indicate the special nature of fiduciary duties.34 Protection of inherently vulnerable persons is the concern of other legal doctrines, such as unconscionability, undue influence or good faith.35 In contrast to notions of conscionability, the fiduciary relation looks to the relative position of the parties that results from the agreement rather than the relative position that precedes the agreement.36

The vulnerability theory is also too narrow. Persons occupying a fiduciary position continue to be bound by strict fiduciary duties even if the beneficiaries have lost confidence in them (such as the case of a child or the patient of a physician) and even if the beneficiary is not vulnerable in any meaningful sense (e.g. a big corporation who hires a lawyer for low-stake litigation). Moreover, in some fiduciary relations (such as the trust) the beneficiaries may be unborn or unascertained.

33 Lac Minerals Ltd. v. International Corona Resources Ltd. [1989] 2 S.C.R. 574 at 599: “The one feature, however, which is considered to be indispensable to the existence of the [fiduciary] relationship… is that of dependency or vulnerability.” In Frame v. Smith (1987) 42 DLR (4th) 81 at 137, Wilson J. defined vulnerability as “the inability of the beneficiary (despite his or her best efforts) to prevent the injurious exercise of the power or discretion combined with the grave inadequacy or absence of other legal or practical remedies to redress the wrongful exercise of the discretion or power.” (Ibid. emphasis added). See also Hospital Products Ltd. v. United States Surgical Corp. (1984), 55 A.L.R. 417 at 432, per Gibbs C.J.: “[T]he reason for the [fiduciary] principle lies in the special vulnerability of those whose interests are entrusted to the power of another to the abuse of that power.” Mason J. in the same case stated that the critical feature in these relationships is that “[t]he relationship… gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.” (ibid. at p. 454).34
34 As Jay Shepherd observed, “[i]t is patent that people go around relying on others all the time, without necessarily creating a fiduciary relationship as a result.” Jay C. Shepherd, supra note 31 at 58.
2.2.3 The incomplete contracts argument

The neoclassical law and economics understanding of fiduciary duties is another dominant current of thought aiming to explain the existence of fiduciary duties. Law and economics views fiduciary duties as mere implied contractual terms. They are fashioned ex post by courts, which is a more efficient alternative to ex ante detailed promises and extensive monitoring.

The standard law and economics approach to fiduciary duties is based on two key concepts: separation between ownership and control over an asset and the agency costs that such separation engenders. The premise for the separation of the two prerogatives is that one party, who owns property (in the sense of controlling and deriving the residual benefit from such property), but who lacks the necessary resources to manage it, delegates open-ended management power to another person. The first party is usually referred to as the principal, and the second the agent. Both the principal and the agent are rational wealth maximisers. Because the agent does not own the asset, he will not reap all the benefits of maximising its value. Therefore, he will seek to maximise his own utility, by shirking his responsibilities or stealing. The principal anticipates this, but due to high transaction costs and to the limits of human rationality, he cannot address in the contract with the agent every contingency that may occur and every action that the agent is to perform. Furthermore, it would be too costly or impracticable for the principal to monitor and effectively discipline the agent’s performance. Consequently, the law intervenes and fills the gaps in the agreement between the owner and the manager, by imposing on the latter strict fiduciary duties. The actual content of these duties is spelled out ex post by the courts, based on a hypothetical bargain between the principal and the agent.

The contractarian theory of fiduciary duties misses the essential feature of a fiduciary relation: the role of fiduciary’s judgment. The role of the fiduciary is not to do what the beneficiary would have wanted or bargained for in every situation where judgment is

required. On the contrary, fiduciaries have a duty not to fetter their judgment and not to delegate discretion. Consequently, the core concern of fiduciary law is proper exercise of judgment, not replicating a bargain between the fiduciary and the beneficiary. What the beneficiary could bargain for is an independent, error-free exercise of judgment, not a given result.

Another shortcoming of the neoclassical contractarian approach is its assumption that behaviour is exclusively based on logical reasoning and self-interest. It does not take into account non-rational or unconscious processes in decision-making. However, extensive cognitive psychology and behavioural research carried over the past decades shows that human judgement and choice is also subject to numerous heuristics and cognitive biases. These influences may lead to systematic deviations from the normative assumptions central to the model of rational decision making.

2.2.4 Conclusion on the traditional justifications

The shortcomings of the deterrence, vulnerability, and other related explanations of the strictness of fiduciary duties stem from the fundamental misunderstanding of what a conflict on interest is. The ‘conflicting interests’ approach fails to capture the specific meaning that a situation of conflict of interest has in fiduciary law: that of incompatibility between the fiduciary’s self-interest and his core decision-making duty. Undoubtedly, in many instances where the fiduciary’s self-interest is in opposition with his core duty, there is a second-degree opposition between the fiduciary’s interests and those of the beneficiary. Focusing on this second-degree opposition instead of the main conflict, however, strips the fiduciary from his essential role, that of exercising discretion, or judgment for the benefit of the beneficiary, and inevitably creates confusion concerning what the proscriptive duties aim to protect and why they are so strict.

The starting point of the conflicting interests approach is that, because the fiduciary has scope for exercise of power or discretion, and is tempted to act self-interestedly, his self-regarding interests come into conflict with beneficiary’s interests. This temptation of profits

has even been compared to a condition that affects fiduciaries, a disease against which they must be protected. The strict fiduciary duties aim to prevent or protect against the disease of temptation. This understanding of fiduciary duties leaves unanswered the following fundamental question: What is so unique in the position of a fiduciary, that the law is concerned with removing temptation of self-interest and with preserving appearance of correctness? A proper understanding of the notion of ‘conflict of interest’, in the sense of incompatibility between a core fiduciary duty and adverse interests, is fundamental for finding a cogent answer to these questions.

3. Conflict of interest and proper exercise of judgment: an interdisciplinary approach

As the previous section explains, the dominant fiduciary law theory justifies the severity of the prescriptive duties based on the imbalance existing between parties to a fiduciary relation. This imbalance creates numerous opportunities for abuse by the dominant party, the fiduciary, and puts the weaker party ‘at the mercy of the other’s discretion.’ Because such abuses are difficult to discover, it is argued, the law must discourage firmly fiduciaries who may be tempted to abuse their superior power.

This understanding is flawed because it fails to explain why the mere presence of self-interest interferes with a fiduciary’s ability to exercise discretion. The connection between self-interest and proper exercise of discretion is a theme explored in detail by the emerging social sciences literature on conflicts of interest. Building on empirical psychological and economic research, cognitive and behavioural researchers from various areas of social sciences have contributed to the emergence of an interdisciplinary ‘standard view’ of the meaning of conflict of interest.

The standard view is centred on the idea that the personal interests or preferences of a person in a position to exercise judgment in the service of another may affect the reliability and credibility of this person’s judgment, by interfering, consciously or subconsciously, with the person’s ability to give fair and genuine consideration to factors that are relevant in adopting a decision. When a decision requires judgment, extraneous interests could influence

40 See Harris v Digital Pulse Pty Ltd [2003] NSWCA 10 at paras. 413–414: “[Fiduciary duties] are prophylactic in the sense that they tend to prevent the disease of temptation in the fiduciary - they preserve or protect the fiduciary from that disease… The prevention of or protection from the relevant disease is assisted by the strictness of the standard imposed and the absence of defences justifying departures from it.”
the decision process by tending to make the decision-maker’s judgment less reliable than it would normally be, without rendering it incompetent.

The standard view of conflict of interest brings significant clarifications into the mechanism of adopting decisions on another’s behalf and offers valuable tools for the advancement of the legal theory of fiduciary duties. Building on consistent empirical evidence, it demonstrates that personal interest tends to affect the decision-making process in ways that are beyond the decider’s control, and indeed beyond any form of objective assessment.

3.1 The standard view on conflicts of interest

In the latter half of the twentieth century, a “minor revolution” took place in the understanding of conflict of interest and the most appropriate strategies to manage it.\(^\text{41}\) Breaking off with the traditional view, which advocates the resolution of conflicts between interest and duty by resisting the temptation of selfish acts, the new theory reveals that external interests can affect the judgment of even the most honourable and disciplined persons. Consequently, avoidance or management of conflict situations, rather than abstention, is the desirable course of action.\(^\text{42}\)

The traditional ethical view of conflict situations adopted a virtue-centric approach. A person faced with a choice between interest and duty was expected to do the right and honourable thing and to resist the temptations of selfishness. As long as this person remained virtuous and fulfilled his primary duties, nothing morally wrong occurred.\(^\text{43}\) The main flaw of this view is that it overestimates the ability of conflicted individuals to know if their judgment has been affected by the interfering interest. The modern view overcomes this flaw by recognising that a person is in a conflict of interest on the basis of being in a conflicted situation, irrespective of the person’s belief that he is capable of resisting the temptation or corrupting influence of the interest that could interfere with his judgment.\(^\text{44}\)


\(^{42}\) Ibid. at 461: “[The] traditional ethical schools of thought were inclined to think that the only morally relevant prescriptive advice in what we are now calling ‘conflict-of-interest situations’ would be to instruct the ‘conflicted’ individual to resist temptation, maintain objectivity and carry out his or her duty. What we now recognize is that this response is naïve: conflicted individuals can have their judgment interfered with even when they try their best to ‘correct’ for the influence of the conflicting interest… In many cases they may not even be aware of the influence some source of bias may have over them…”

\(^{43}\) Ibid. at 447.

\(^{44}\) Ibid. at 461.
The traditional ethical view of conflict situations coincides with the dominant legal justification of fiduciary duties. In both fields, how a person responds to a situation of conflict tends to be regarded exclusively as a matter of incentives and conscious choice: the rightful course of action is to resist temptation, while the wrongful option is to act opportunistically.\(^{45}\)

The standard view of conflict of interest is built on recent developments concerning decision-making processes made in cognitive sciences. It has been demonstrated that interests affect the way in which a person evaluates the seriousness of various risks, the desirability of certain outcomes, or the perception of connections between cause and effect. Consequently, conflicts of interest situations are reprehensible not because they create a measurable bias, but because they create an “unusual risk of error,”\(^{46}\) thus rendering one’s judgment less reliable.\(^{47}\)

The literature on cognitive and motivational biases provides detailed theoretical and empirical information on the ways in which personal interest can interfere with the judgment or motivation of a person. The inter-disciplinary understanding of the ways in which interest affects judgment is based on a long-standing distinction drawn by psychologists between two different modes of information processing that characterize human cognition. On the one hand there are automatic processes that are relatively effortless and unconscious. On the other hand, there are controlled processes, more analytical and more effortful. Automatic and controlled processes often act in concert to produce judgments and decisions, but in certain predictable situations they can come into conflict. In the case of professionals, the two different modes of thinking are illustrated by two different sets of motives: professional responsibilities and

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\(^{45}\) See Don A. Moore, Lloyd Tanlu and Max H. Bazerman “Conflict of Interest and the Intrusion of Bias” (2010) 5 Judgment and Decision Making 37 at 46-47, emphasis added: “In analysing the problem of conflict of interest in business, both the mass media and the academic literatures in business, accounting, and law routinely assume that bias is a matter of deliberate choice… Bias, to the extent that it exists, must, in this view, be a deliberate response to incentives. This ‘economic’ account of conflict of interest is challenged by psychological research which suggests that biased information processing is not only pervasive, but is typically unconscious and unintentional - i.e., seldom a matter of deliberate intentional choice… [P]rofessionals who face conflicts of interest may find it difficult, if not impossible, to simply choose objectivity.”


\(^{47}\) Norman and MacDonald, supra note 41 at 464: “[C]onflict of interest situations pose a problem even when they are not exploited in corrupt ways. This is in part because conflicting personal and even professional interests can impair the judgment of even the most dedicated and conscientious expert.” See also Don A. Moore and George Loevenstein, “Self-Interest, Automaticity, and the Psychology of Conflict of Interest” (2004) 17 Social Justice Research 189 at 189, emphasis added: “The role played by cognitive factors has been largely ignored in the academic literature on conflict of interest, which has been dominated by academics who adhere, more or less closely, to a rational choice perspective… [S]uccumbing to a conflict of interest - putting one’s own interests above professional responsibilities - has been viewed, in the media, by the public, and by academics, as a matter of deliberate corruption. The evidence reviewed here, however, is consistent with the conclusion… that the violations of professionalism induced by conflicts of interest often occur automatically and without conscious awareness.” Therefore, “[d]eterrence of misbehaviour using the threat of legal punishments is a clumsy public policy tool for achieving the goal of strengthening professional norms.”
personal interests. As is the case of automatic and controlled processes, these motives often coincide and reinforce each-other. When professional responsibilities and self-interest point in opposite directions, however, self-interest exerts a more automatic influence than professional responsibilities, which are more likely to be governed by controlled processing. Since automatic processing tends to occur outside of conscious awareness, its influence on judgment and decision making is difficult to eliminate or correct entirely. Consequently, self-interest often prevails, even when decision-makers consciously attempt to comply with the rules regulating their role or profession.\(^{48}\)

Although the empirical research on cognitive and motivational biases is relatively recent,\(^{49}\) a core body of knowledge has been accumulated. These developments are extremely useful for understanding the phenomenon that fiduciary law aims to address, and on shaping rules that are likely to be effective in dealing with it.

The contemporary preoccupation with the appropriate understanding of a conflict of interest situation was triggered in early 1980s by the innovative work of Michael Davis.\(^{50}\) The most relevant subsequent attempts to clarify this concept were framed explicitly in reaction to Davis’ theory. As a result of these debates, several features of a conflict of interest situation have emerged as largely accepted, forming the basis of a standard view of conflict of interest.\(^{51}\) It is important to note from the beginning that the main purpose of the standard view is to determine the moral or ethical consequences of a conflict of interest. Fiduciary law theory, instead, is concerned with understanding the existing legal rules regulating conflicts of interest in private law. Despite its specific objective, the standard view can help legal scholars acquire an in-depth understanding of the ways in which a situation of conflict of interest affects the conflicted person.

The standard view rejects as superficial the identification of a conflict of interest situation with the principal-agent problem, which has dominated the philosophical and legal


\(^{49}\) Norman and MacDonald, supra note 41 at 459.

\(^{50}\) Michael Davis, “Conflict of Interest” (1982) 1 Business and Professional Ethics Journal 17.

\(^{51}\) The ‘standard view’ on conflict of interest was articulated by Michael Davis based on the work of scholars from various fields (philosophy, political theory, ethics, law). See Michael Davis, “Introduction”, in Michael Davis and Andrew Stark, eds., Conflict of Interest in the Professions (Oxford: Oxford University Press, 2001) 3-19.
literature of conflicts of interest of the past decades. The principal-agent problem (or agency problem) arises when the goals of the principal and those of the agent diverge, and it is costly or impracticable for the principal to monitor the agent’s actions. In the standard view, a person has a conflict of interest if:

(a) he is in a relationship with another requiring him to *exercise judgment* in that other’s service and
(b) he has an interest *tending to interfere* with the proper exercise of judgment in that relationship.

Judgment is a central notion in the standard view of conflict of interest. Fundamental to the notion of conflict of interest is that someone’s ability to exercise proper judgment is at risk of being affected by a personal interest or by a competing duty to exercise proper judgment.

The concept of judgment denotes the existence of discretion, in the sense of absence of a pre-defined script or algorithm based on which a decision can be modelled. In a situation requiring the exercise of judgment, the specification of the *problem* to be solved or the *ends* to be achieved are contested, or open to interpretation.

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52 MacDonald and Norman, *supra* note 41 at 446: “[T]here is generally assumed to be a difference between a true ‘conflict of interest situation’ and a generic ‘principal-agent’ problem. It may be that most conflicts of interest can be conceived of as involving at least one agent… and at least one principal. But nobody who takes the concept of ‘conflict of interest’ seriously will want to conflate the conflicts of interest and generic principal-agent problems…”

53 See generally Michael C. Jensen, “Organization Theory and Methodology” (1983) 58 Accounting Review 319-339; Neil R. Luebke, “Conflict of Interest as a Moral Category” (1987) 6 Business and Professional Ethics Journal 66 at 77. Although the standard view of conflict of interest has become established, some ethics theorists continue to use conflict of interest to refer to situations of conflicting interests, rather than conflict between interest and judgment. See e.g. Archie B. Caroll, “Ethics in Management” in Robert Frederick, ed., *A Companion to Business Ethics* (Oxford: Blackwell Publishers, 1999) 141 at 145: “Virtually all ethical issues managers face may be characterized as a conflict of interest. The conflict usually arises between the manager’s own values or ethics and those of his employer, employees or some other stakeholder group which has an interest in the decision.”; O. C. Ferrell *et al*., *Business Ethics: Ethical Decision Making and Cases*, 7th ed. (Boston: Houghton Mifflin, 2008) 67: “A conflict of interest exists when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group.”

54 Michael Davis, “Conflict of Interest”, *supra* note 50 at 21, emphasis added.

55 Norman and MacDonald, *supra* note 41 at 455. See also W. Bradley Wendel, “The Deep Structure of Conflicts of Interest” (2003) 16 Georgetown Journal of Legal Ethics 473 at 477, emphasis added: “A conflict of interest arises when a person (the agent) stands in a relationship of trust with another person (the principal) that requires the agent to exercise judgment on behalf of the principal, and where the agent’s judgment is impaired because of another interest of the agent.”; Dennis F. Thompson “Understanding Financial Conflicts of Interest (1993) 329 New England Journal of Medicine 573 at 573, emphasis added: “A conflict of interest is a set of conditions in which professional judgment concerning a primary interest (such as patient’s welfare or the validity of research) tends to be unduly influenced by secondary interest (such as financial gain).”

judgment are routine, mechanical or ministerial - “they have (something like) an algorithm.”

Ministerial decisions require only technical rationality. Specific theories or techniques are available to determine the most appropriate way to achieve, pre-defined unambiguous goals.

Given the absence of a pre-defined pattern regarding the ends to be attained and the means to achieve them, exercise of judgment goes beyond mechanical rule-following and entails “the ability to make certain kinds of decisions correctly more often that would a simple clerk with a book of rules… and only the same information.”

Judgment entails knowledge, skill and insight, and the interactions of these factors can produce unpredictable results. When a decision requires judgment, different decision-makers may disagree on the ends to be pursued and on the optimal course of action, without anyone being wrong in an objective, measurable sense. In this scenario, a situation of conflict of interest impairs the decider’s capacity to evaluate the possible ends and other matters of judgment, but it does not affect his overall level of competence.

Extraneous interests interfere with judgment not as ends that a decision-maker has in view, but as factors that tend to influence the ends in view (i.e. promoting another’s interests). In other words, the standard view does not start from the premise that a person who must exercise judgment for another yields to temptation and decides to pursue his own interests. It is based, instead, on the idea that the presence of such interests puts at risk the decision-maker’s ability to evaluate the weight to be given to the relevant considerations on which the decision is based.

The standard view provides an essential clarification of the issues at stake in a conflict of interest: the interests that create a risk to proper judgment are not ends that the decision-maker has in view, but factors that tend to influence his evaluation of the ends in view. Personal material interest is the clearest example. The possibility of obtaining a personal unauthorised material gain as a result of a decision creates a situation of conflict, although the decision-maker does not consciously pursue his own material interests. The mere presence of

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57 Michael Davis, “Conflict of Interest”, supra note 46 at 590.
59 Michael Davis, “Introduction”, supra note 51 at 8: “Where judgment is necessary, different decision-makers, however skilled, may disagree without either being clearly wrong.” See also Michael Davis, “Conflict of Interest”, supra note 50 at 22: “Judgment implies discretion… A bank president does not need judgment to decide whether she (as president) should embezzle the bank’s money… In contrast, a critic needs judgment to decide how good a play or actor is.”
60 Michael Davis, “Introduction” supra note 51 at 9-10: “On the standard view, interests are not ends in view as much as factors tending to shape the ends that one has in view… What conflict of interest affects are the ends in view, the evaluation of this or that means, and other matters of judgment within the bounds of competence.”
the possibility of such a benefit affects the reliability of the decider’s evaluation of the relevant factors on which he bases his decision. If a decision-maker consciously acts with a view to obtaining an unauthorised benefit, not only he exercises judgment inappropriately, but he also steals or misappropriates.

Interest another essential concept for the standard view of conflicts of interest. Since perturbing interests affect the decision-making process as factors that tend to influence the ends in view, the extent of the effect of such interests on one’s judgment cannot be assessed based on the actual decision taken. Because the decision-maker is the person who is charged with deciding the appropriate course of action, one cannot simply measure the deviations from a ‘right’ decision, which the interfering interest had caused. 61 A decision adopted in a situation of conflict is inherently flawed, despite the conflicted person’s willingness to put aside personal interests and ideological commitments. Since the effect of a conflict of interest cannot be assessed based on results, the theories of conflict of interest focus on certain kinds of identifiable interests that are particularly threatening to the exercise of judgment, such as material interests or family ties. The categories of interfering interests, however, should not be considered closed. 62

Although in the standard view interest is an open-ended concept, it does not include just any factor that might compromise one’s judgment. First, it excludes factors that may impinge upon one’s level of professional competence. Second, not all personal preferences can be set aside. Decision-makers cannot be required or expected to transcend all aspects of their subjectivity and act like de-humanized, deciding machines. It is not psychologically feasible to divest oneself entirely of interests that are constitutive of one’s personhood. Some subjective preferences may be harmless: not every decision that a person makes on another’s behalf is influenced by every interest, and not every interest renders judgment unreliable. 63

61 To illustrate how interests affect judgment, Davis compared a conflict situation to dirt in a sensitive gauge. The dirt causes the gauge to work unpredictably, thus affecting its reliability (Michael Davis, “Conflict of Interest”, supra note 46 at 591). Because interests affect judgment in unpredictable ways, “courts are incapable of measuring the extent to which [the decision-maker’s] decisions deviate from the true public interest, and then [use] that deviation as an indicator -a proxy- of the extent to which [the decision maker’s] judgment may have been impaired.” (Andrew Stark, Conflicts of Interest in American Public Life (Cambridge, MA: Harvard University Press, 2000) 21, referring to judicial review of administrative decisions).

62 Michael Davis, “Introduction”, supra note 51 at 9-10: “On the standard view, an interest is any influence, loyalty, concern, emotion, or other feature of a situation tending to make [the decision maker’s] judgment (in that situation) less reliable than it would normally be, without rendering [it] incompetent… What in fact constitutes a conflict of interest is an empirical question… It is therefore a mistake (on the standard view) to make a list of what constitutes relevant interests.”

63 Michael Davis, “Introduction” supra note 51 at 10.
A prohibition of all subjective beliefs, commitments, and loyalties is not only unfeasible, but it goes against the core idea of exercise of discretion. The combination of personal characteristics that is specific for each decision-maker accounts for the diversity of equally-valid results that can occur in a situation involving discretion. Consequently, a line needs to be drawn between legitimate factors that influence the decider’s judgment and factors that have the ability to create a conflict of interest. In Stark’s terms, the interests that should be encompassed by the notion of conflict of interest are those which create a normatively significant influence on the decider’s judgment. Although what amounts to a normatively significant interest is open to debate, the standard view seems to limit interest to factors that are able to affect the reliability of a decision-maker’s judgment by their simple existence as potentiality.

3.2 Managing conflicts of interest

The standard view of conflicts of interest is a vital foundation for devising effective responses to conflict of interest situations. Cognitive research shows that people have an imperfect understanding of the effect of self-interest on their judgment and of the optimal way of correcting the biases that self-interest creates. Individuals have little insight into their cognitive processes, and may thus be unable to detect if, and to what extent, their judgment reflects of self-interested motivations.

One line of research shows that people tend to underestimate the biasing effect of self-interest on themselves. Because they cannot have an objective understanding of the effect of self-interest on their decision-making, people tend to think that they can resist the effects of self-interest. They tend to discount self-interest as their own motivation and overestimating the role of self-interest in motivating other people.

Other studies show the opposite tendency. When people are aware of a situation where a self-interest bias could plausibly exist, they tend to assume that the bias exists and is

64 Andrew Stark, supra note 62 at 241; W. Bradley Wendel, supra note 55 at 486-487.
65 Andrew Stark, supra note 62 at 119-120.
influencing them. The more committed a decision-maker is to fairness and objectivity, the more likely he is to over-compensate for the presumed bias of self-interest, thus undermining the quality of his decision. This “incorrect correction” is caused by people’s inability to gauge the actual effect of self-interest on their own judgment. 68

Given the inability to measure accurately the effects of self-interest on judgment, what is an effective response to a conflict of interest situation?

Avoidance is perhaps the best solution to conflict situations. Persons having a duty to exercise judgment in the interest of another must avoid situations in which their interests pose an actual or potential threat to the reliability of their judgment. Although avoidance of conflict situations is an important duty of decision-makers, a flat prescription to avoid all conflicts of interest is not only mistaken, but also unworkable. On the one hand, not all conflicts of interest are avoidable. Some conflict situations are embedded in the relation, while others occur independently of decision-maker’s will. 69 On the other hand, the mere fact of being in a situation of conflict is not always wrong from a moral, ethical or legal point of view. Failure to address the conflict situation, however, may be reprehensible. 70

Another potential strategy is to disclose the conflict to those relying on one’s judgment. Common sense suggest that complete disclosure will give the beneficiaries the opportunity to give informed consent to the situation of conflict, to adjust reliance accordingly, or to replace the decision-maker. Except the latter scenario, disclosure is an effective response if it does not affect the decision-maker’s judgment process and if the beneficiary is able to correct adequately for that biasing influence. 71 Psychological research shows that neither of these conditions may be met. Sometimes both parties may be worse off following disclosure. 72

68 Amy D. Shelton supra note 66.
69 For instance, a lawyer may be placed in a conflict of interest situation if one of his clients decides to sue another of his clients. In this example (more accurately referred to as a duty-duty conflict), the lawyer’s exercise of professional judgment for one of the litigating clients may be impaired by the other litigating client’s interests covered by the lawyer’s core fiduciary duty to the later client.
70 Michael Davis, “Conflict of Interest”, supra note 46 at 592: “Having a conflict of interest is not like stealing money or taking a bribe. One can have a conflict of interest without doing anything wrong. To have a conflict of interest is to have a moral problem. What will be morally right or wrong, or at least morally good or bad, is how one resolves that problem.”
Disclosure may have the unintended consequence of liberating a decision-maker from concerns about ethicality and give him a moral license to bias his decision even further. Moreover, knowing that the beneficiary is likely to discount the decision to correct for the self-interest, the decision-maker may be tempted to counteract this adjustment by allowing self-interest to influence their decision even further.

There is also research showing that beneficiaries of disclosure do not adjust to counteract the self-interest. Paradoxically, beneficiaries could see disclosure as a sign of the decision-maker’s trustworthiness, and may increase their confidence in the judgment. Moreover, beneficiaries of disclosure are unlikely to be sophisticated enough to be able to adjust adequately their reliance on the judgement in question.

Another potential response to the problem posed by a conflict of interest is escape. The decision-maker can escape the conflict by re-defining the scope of the relationship, so that the scope of the judgment is restricted; by divesting himself of the interest creating the conflict; or, where possible, by withdrawal from the relationship. Divestment of the conflicting interest, however, may not be entirely effective. A person who in the past had an interest in the outcome of a decision cannot be said to be in the same psychological position as someone who was never interested in that matter.

4. The relevance of the standard view of conflict of interest for the law of fiduciary duties

How does a decision-maker select relevant factors, assign their appropriate weights and reach what he believes to be the most adequate decision? An increasingly popular trend in legal scholarship uses theories developed by cognitive and behavioural sciences in order to acquire a better understanding of the existing legal rules regulating the judgment and decision making process of legal actors in various contexts. The emerging law and psychology field

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73 Daylian M. Cain, et al., supra note 71 at 7.
75 Daylian M. Cain, et al., supra note 71 at 6.
76 Ibid. at 20-21.
77 Michael Davis, “Conflict of Interest”, supra note 46 at 592.
78 Dave T. Miller, supra note 74 at 129.
improves both the descriptive and the normative legal analysis by offering a more in-depth understanding of existing legal rules regulating judgment and decision-making. So far, legal scholars have applied psychology theories and insights mostly in public law, in relation to decision-making by juries, judges and administrative decision-makers.

The application of cognitive sciences insights to fiduciary law is in incipient stages. Alexander is one of the first scholars to adopt such an approach. He used several cognitive theory concepts to rebut the traditional law and economics view that fiduciary duties are nothing but a species of contractual obligations. Alexander’s theory demonstrates the discrete nature of fiduciary relations based on the model of cognitive analysis that the courts use when deciding cases involving breach of fiduciary duty. In breach of fiduciary duty cases, Alexander argued, courts have a tendency to apply top-down cognitive processes, which are theory-driven and therefore more sensitive to the judge’s preconceived notions and expectations. In cases of alleged breach of contract, in contrast, courts use a bottom-up cognitive method, which is data-driven and, consequently, largely insulated from the judges preconceived views.

Alexander’s theory, while providing important new arguments for the specificity of fiduciary relationships, does not engage with the intrinsic features of legal relations that attract fiduciary duties. This paper uses insights from cognitive sciences to further the analysis of fiduciary relations by focusing on their substantive features. If the notion of conflict of interest is properly understood, it becomes clear that fiduciary law rules have already incorporated these insights and have been fashioned to prevent or reduce the unwanted consequences of erroneous decision-making processes.

The role of the standard view of conflicts of interest in understanding fiduciary law is mostly descriptive, rather than normative. The philosophical view of conflict of interest helps lawyers understand the proper scope and justification of firmly established rules. Its main aim

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83 Ibid. at 768.
is not to dictate how the law should be; rather, it brings scientific, albeit meta-juridical, explanation of the justification of the proscriptive duties. As Chapter 2 has shown, courts have constantly affirmed the very strict nature of the proscriptive duties since the earliest stages of fiduciary law. In very rare occasions, several courts have emphasised that judges are ill-equipped to investigate whether the core fiduciary duty has been breached. The standard view helps lawyers understand why this is so – the effect of self-interest is unpredictable and escapes any measurement.

The cognitive research on the unwanted effects of disclosure, however, should prompt lawyers to re-think the weight they place on disclosure and informed consent as a cure to a conflict of interest situation.

5. Conclusion

The proper exercise of judgment or discretion is the law’s main concern in regulating fiduciary relations. Irrespective of the label used (such as fiduciary duty, duty of loyalty, duty to exercise sound discretion, duty of real and genuine consideration), the central duty binding on every person holding a fiduciary power aims to guide the fiduciary’s exercise of discretion by regulating the decision-making process.

The primacy of the decision-making process explains why fiduciary law comprises stringent proscriptive duties. Adopting a decision in a conflict of interest situation amounts to a flawed decision process, irrespective of the actual outcome of such decision. The presence of an actual or potential personal interest on the fiduciary’s part in the outcome of a decision process flaws this process by affecting the fiduciary’s ability to evaluate the weight that relevant factors should bear in his decision. Although the biasing effect that self-interest has on judgment is well-established in other areas of social sciences, contemporary fiduciary law theory largely ignores it.

One of the main causes of this oversight is the continuous attempts to find a theoretical foundation for the proscriptive duties independently of the core feature that is specific to a fiduciary position: power to affect the legal or practical interests of another, coupled with a duty to exercise it in the best interest of another or for the purpose for which it was granted. The view that has dominated the fiduciary law theory throughout twentieth century was based on the premise that fiduciaries inevitably exploit to their advantage their superior position, and therefore need to be disciplined. The law’s concern with prevention of abuse or misappropriation, however, spreads across various legal fields. Therefore, it cannot be the
central feature that sets fiduciary law apart. Recent research in various fields concerned with conflicts of interest has demonstrated that self-interest can affect the proper exercise of judgment in ways that often escape measurement or control. The main reason why fiduciary law is concerned with the management of actual or potential situations of conflict is not prevention of abuse by stifling temptations. It is protection of beneficiary’s right to fiduciary’s unencumbered and genuine judgment. Disciplining legal actors and reinforcing the general confidence in legal relations are, at best, secondary effects of fiduciary law and, indeed, of any private law rules.