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I. Introduction

In the early spring of 2013, Swarthmore College faculty met to discuss student demands that the school divest its holdings in companies that deal in fossil fuels.[1] As a speaker began explaining how that decision would lose the school millions of dollars, student activists hijacked the meeting and silenced objectors.[2] The activists' behavior shows the emotion that sometimes pervades the issue of socially responsible investing, or "SRI" for short. SRI is the practice of screening investments according to environmental, social, moral, and ethical criteria. Whether caretakers of other people's money, such as trustees and financial advisers, ought to engage in SRI is frequently—and sometimes heatedly—debated. But to come to a correct conclusion, emotion cannot mask cold hard truth. Trustees and advisers have legal obligations known as fiduciary duties,[3] and these duties may prohibit SRI. Much contemporary commentary on this topic is based on the premise that fiduciary duties do not stand athwart SRI,[4] and thus tackles the issue from the standpoint of policy, asking "should a fiduciary engage

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1. *See* Thomas Sowell, *Barbarians at the Campus Gates*, NAT'L REV. ONLINE (May 21, 2013), http://www.nationalreview.com/article/348852/barbarians-campus-gates-thomas-sowell.

2. *See id.* (explaining how the activists seized the microphone and "shouted down a student who rose in the audience to object").

3. *See infra* note 13 and Part III.B.

4. *See, e.g.*, *infra* note 203 and accompanying text.

in SRI?" However, this premise is wrong. As this article shows, unless measures have been taken under certain legal doctrines, fiduciary duties absolutely do prevent SRI. Unlike many other critiques on the subject, this article looks at SRI from a legal rather than political point of view, asking "may a fiduciary engage in SRI?"

Part I of this article clarifies and strictly defines the frequently nebulous idea of SRI, explaining its history, trends, and current status. To give perspective and perhaps temper hype, Part II discusses the efficacy of SRI as a method of change, concluding that while SRI may not have much effect on air quality or oppressive foreign governments,[5] there are situations where SRI is useful and even necessary. Part III looks at the conflict between SRI and the fiduciary duties of trustees, investment advisers, and broker-dealers. It shows the contractual nature of fiduciary duties and why this is relevant for SRI. Part III also explores important legislation, such as ERISA, that affects fiduciary duties in certain circumstances. Further, Part III examines the superficial and non-legal analysis in some of the high-profile commentary on SRI. Part IV offers the legal analysis that has been lacking, examining SRI through the doctrines of authorization and ratification, as well as determining the effects of exculpation clauses in trust instruments and contracts. The article concludes by explaining when SRI is lawful for fiduciaries and instructing them as to how they can engage in SRI without fear of breaching their fiduciary duties.

A. *The Definition, History, and Current State of SRI*

The definition of SRI tends to change depending on who is speaking. However, to reach specific conclusions about SRI, it must have a specific definition. This part defines the term and explains why that definition is accurate. Then this part outlines the history of SRI, concluding with a description of its current state.

5. It is important to note that while shareholder activism, such as shareholder resolutions, may affect corporate behavior, shareholder activism is not SRI, *see infra* note 11 and accompanying text, and is beyond the scope of this Article.

1. What Is SRI?

Some commentators say that SRI has no strict definition,[6] yet at the same time admit that SRI may put a fiduciary at risk of being sued.[7] Behavior that can lead to legal liability ought to have a firm definition so that people can be certain when they are or are not engaging in such behavior. Loose definitions lead to sloppy thinking, which in turn leads to wrong conclusions about whether certain behavior is lawful.[8] Furthermore, it is easy to define SRI with clarity and precision. Professor John H. Langbein and Judge Richard A. Posner have already done so: SRI is "excluding the securities of certain otherwise attractive companies from an investor's portfolio because the companies are judged to be socially irresponsible, and including the securities of certain otherwise unattractive companies because they are judged to be behaving in a socially laudable way."[9]

In other words, SRI is making an investment decision based on social, rather than financial, criteria.[10] SRI is not shareholder activism (e.g., introducing a shareholder resolution) since SRI refers to the act of investing whereas activism occurs only after an investment is made.[11] Nor is SRI the practice of

6. *See, e.g.*, Joel C. Dobris, *SRI—Shibboleth or Canard (Socially Responsible Investing, That Is)*, 42 REAL PROP. PROB. & TR. J. 755, 756 n.4 (2008) (stating that SRI has no strict definition and that its definition is disputed).

7. *See, e.g.*, *id.* at 760 ("When can a fiduciary take extra risk, in all likelihood by screening out unloved assets, and not get successfully sued?").

8. *See e.g.*, discussion *infra* Part III.D.

9. John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 73 (1980). Implicit in this definition are two sub-types of SRI, often called "negative" and "affirmative." *See* JOAKIM SANDBERG, THE ETHICS OF INVESTING: MAKING MONEY OR MAKING A DIFFERENCE? 28–30 (2008). Negative screening occurs when the investor avoids investing in a company for social or ethical reasons, whereas affirmative screening happens when the investor decides to invest in a company because of social or ethical criteria. *See id.* However, distinguishing between these two types of SRI is unnecessary for purposes of this article, because fiduciary duties apply regardless of whether a fiduciary screens negatively or affirmatively; and in both cases, the fiduciary uses social rather than financial criteria in deciding whether or not to invest.

10. *See* Michael Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 689 (2002).

11. *See, e.g.*, *id.* at 691 ("SRI should . . . be distinguished from shareholder

examining social and political factors to determine how those factors will influence the investment financially.[12] For example, if a trustee decides to invest trust funds in a company because that company has good environmental policies and the trustee believes that those policies will result in profit for the company and strong financial return for the trust, this is not SRI. But why is this not SRI, given that the decision was based on the company's environmental policies? The answer is that the fiduciary duty of care, which requires fiduciaries to make prudent investment decisions for the good of the beneficiaries, would likely compel the trustee to make that same decision anyway based on the fact that it is a financially prudent choice.[13] In fact, it is pointless to discuss whether a fiduciary may decide to invest (or not) according to environmental criteria if those criteria determine the investment's financial aspect—that question is easily answered, and the answer is yes.[14] Real SRI occurs when a fiduciary makes an investment decision based on criteria wholly separate from the investment's financial aspects. For instance, when a fiduciary decides to avoid investing in a company—despite its promise of profit—solely because the company produces fossil fuels or has no women in management

activism . . . . Buying one share of Philip Morris and seeking to place a shareholder resolution on the ballot directing the company to stop producing cigarettes . . . might be socially responsible, but it is not [SRI].").

12. *See id.* ("SRI should . . . be distinguished from the practice of examining socially and politically charged factors that might impact on financial soundness . . . .").

13. This article explains fiduciary duties in depth in Part III.B, but here is a basic explanation: A fiduciary has two fundamental duties, those of loyalty and care. *See* Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1047 (1991) ("[M]isappropriation . . . is governed by the duty of loyalty, and . . . negligent mismanagement . . . is governed by the duty of care."). The duty of loyalty requires the fiduciary to act in the best interest of the beneficiary or client at all times, prohibiting behavior such as self-dealing or usurping business opportunities. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 78 cmts. c–d (2007); RESTATEMENT (THIRD) OF AGENCY §§ 8.01–8.06 (2006); RESTATEMENT (SECOND) OF TRUSTS § 170 (1959). The duty of care requires the fiduciary to act prudently to make sound investment decisions that maximize the beneficiary's or client's income, meaning that a fiduciary must take financial considerations into account when making investment decisions. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 77 (2007); RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006); RESTATEMENT (SECOND) OF TRUSTS § 174 (1959).

14. *See supra* note 13 and accompanying text; *see also infra* note 15.

positions, this is SRI. Of course, it is possible that acting in the beneficiary's best interest may result in a socially responsible investment, but that would not be SRI.[15] Failure to grasp this leads to the mistake of thinking that the duty of care can actually compel SRI.[16] The criteria underlying true SRI are unrelated to the beneficiary's financial interest; therefore, fiduciary duties can never force SRI,[17] though they may prevent it.

B. *The History and Current State of SRI*

Though SRI may be "in fashion,"[18] it has existed at least as early as the nineteenth century.[19] Originally, it was a practice

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15. *See* James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 124 U. PA. L. REV. 1340, 1345 (1980).

> It may be that labor-relations practices, compliance with environmental or safety standards, or other policies could affect the financial stability and profitability of a company whose securities are being analyzed. If the fiduciary performing the financial analysis of the investment activity has a sound empirical basis for considering these factors, then their use is defensible on purely financial grounds. The fiduciary does not override basic financial investment considerations for the sake of a social objective, nor does he temper judgments on comparable alternatives by focusing on noninvestment factors. The question of 'social investing' never arises in this setting, and we need not confuse the legal analysis applicable to 'social investing' by belaboring such practices.

Id.

16. *See, e.g.*, *infra* note 201 and accompanying text.

17. However, there may be a situation, as explained in Part IV.A, where a fiduciary is under a contractual, rather than fiduciary, duty to conduct SRI.

18. Dobris, *supra* note 6, at 767.

19. *See* Knoll, *supra* note 10, at 684. Professor Knoll cites evidence of Quakers practicing SRI as early as the 17th century. *Id.* at 684 n.17 (citing Amy L. Domini, *What Is Social Investing? Who Are Social Investors?*, *in* THE SOCIAL INVESTMENT ALMANAC 6 (Peter D. Kinder et al. 1992); ANNE SIMPSON, THE GREENING OF GLOBAL INVESTMENT: HOW THE ENVIRONMENT, ETHICS AND POLITICS ARE RESHAPING STRATEGIES 27 (1991)). Professor Knoll also cites Biblical injunctions against usury, *id.* at 684 (citing *Exodus* 22:25; *Deuteronomy* 23:16), but these passages do not concern SRI since they are about limitations on profit rather than investing for the purpose of social change.

of Christian investors who avoided putting their money into activities they considered sinful, such as alcohol and pornography.[20] The first publicly-offered SRI fund was the Pioneer Fund, established in 1928.[21] Like the earlier Christian investors, the Pioneer Fund screened investments from "sin industries."[22] SRI remained a seldom-used method of keeping one's money out of the devil's hands, until the 1960s when the Vietnam War prompted nationwide protest.[23] Much like their ideological progeny at Swarthmore,[24] student war protesters called for universities to divest their portfolios of defense industry stocks.[25] A handful of mainstream SRI funds appeared within the next few years.[26] Social investing became widespread with the western outcry for the abolition of apartheid in South Africa in the 1980s.[27] By 1993, $625 billion in investments was screened, and nearly all of this was for the purpose of causing change in South Africa.[28] Once that country's segregation laws were repealed, the amount of screened investments fell by nearly 75%.[29] It was not long, however, before more people found reasons to screen more of their investments. By 1999, the money in SRI was almost a trillion and a half dollars, with tobacco

20. *Id.* at 684. *See also* Benjamin J. Richardson, *Putting Ethics into Environmental Law: Fiduciary Duties for Ethical Investment*, 46 OSGOODE HALL L.J. 243, 245 (2008) ("[T]he SRI movement began in the anti-slavery campaign of the Quakers in the 1700s.").

21. Knoll, *supra* note 10, at 684.

22. *Id.* The Pioneer Fund exists today in the form of Pioneer Investments, though its mission statement highlights its innovative global investment management and does not refer to Christian screening. *Pioneer's Mission*, PIONEER INVESTMENTS, http://us.pioneerinvestments.com/about/corp/mission.jsp?navid=189&navvr=178 (last visited Mar. 24, 2014).

23. *See* Knoll, *supra* note 10, at 684; Richardson, *supra* note 20, at 249.

24. *See supra* note 1.

25. *See* Knoll*, supra* note 10, at 684.

26. *See id.* at 684–85 (referring to the Pax World Fund, which screened weapons producers, and the Third Century Fund, which invested in companies sensitive to the environment and their local communities).

27. *See id.* at 685; *see also* Bd. of Trs. of the Employees' Ret. Sys. of Balt. v. Mayor & City Council of Balt., 562 A.2d 720 (Md. 1989) (determining the legality of city ordinance prohibiting city pension from investing in South African securities).

28. *See* Knoll, *supra* note 10, at 685.

29. *Id.* at 686.

screens comprising 96% of the total.[30]

Today, over a thousand investment firms have signed the Principles for Responsible Investment,[31] a set of six tenets committing signatories to certain environmental, social, and corporate governance considerations when making investment decisions.[32] These firms manage assets totaling over $30 trillion—about 20% of the total value of global capital markets.[33] At the end of 2012, $3.374 trillion of assets in the U.S. were invested according to socially responsible criteria, a nearly five-fold increase from 1995.[34] And SRI is not just for private investors. The California Public Employees' Retirement System ("CalPERS")—the largest public pension fund in the U.S., with about $260 billion in its coffers[35]—proudly asserts its use of social and environmental standards when making investment decisions.[36] It is evident that many investors admire and use

30. *Id.* Besides tobacco, "[t]he next most common screens [we]re for gambling, alcohol, and weapons."

31. US SIF FOUND., REPORT ON SUSTAINABLE AND RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 5 (2012), *available at* http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf.

32. These principles are commitments to: (1) incorporate environmental, social, and corporate governance ("ESG") issues into investment analyses and decisions; (2) incorporate ESG issues into active ownership policies and practices; (3) seek disclosure on ESG issues by the entities invested in; (4) promote the principles within the investment industry; (5) work with other signatories to more effectively implement the principles; and (6) report on activities and progress toward implementing the principles. PRINCIPLES FOR RESPONSIBLE INVESTMENT, THE SIX PRINCIPLES, http://www.unpri.org/about-pri/the-six-principles/ (last visited Mar. 24, 2014). Note that the second principle refers to shareholder activism, not SRI. Also, some argue that the fact that these principles are heavily subscribed to is unimportant since the principles are vague and do not require specific action. *See, e.g.*, Richardson, *supra* note 20, at 257, 266.

33. US SIF FOUND., *supra* note 31, at 5.

34. *Id.* at 11. However, it is worth noting that this amount represents about 11% of the total assets under management, see *id.*, which is just a small increase from 1999 when "one out of every eleven dollars in assets under management was invested using ethical screening." Knoll, *supra* note 10, at 686.

35. Press Release, CalPERS, CalPERS Receives Commendation for Best Responsible Investment Report (June 12, 2013), https://www.calpers.ca.gov/index.jsp?bc=/about/newsroom/news/2013/responsi ble- investment.xml.

36. *See, e.g.*, CALPERS, TOWARDS SUSTAINABLE INVESTMENT: TAKING RESPONSIBILITY 21 (2012), *available at* http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/esg-report-

SRI. However, before taking its virtues for granted, it is worth examining the effects of SRI on social issues and investors' money.

II. The Effect of SRI on Investments and Social Issues

CalPERS claims that 66% of every dollar it pays in benefits is derived from investments.[37] But CalPERS fails to mention that California taxpayers guarantee the fund and pay the difference when the fund's investments fail to yield sufficient returns.[38] And despite CalPERS's ballyhoo about the financial benefits of SRI, investment failure is rampant in the fund and is often a direct result of SRI. For example, CalPERS divested its tobacco holdings;[39] tobacco shares then rose and CalPERS missed $1 billion in profits.[40] The fund's decision to avoid investing in countries with poor labor records, like China, cost about $400 million.[41] Investments in clean energy yielded the fund a return of negative 9.7%, though CalPERS's chief investment officer, Joseph Dear, did note that it was "a noble way to lose money."[42]

Some believe that SRI can never be more than a losing bet, and that the only value in it at all is "consumptive"[43]—the satisfaction in having promoted a noble cause. Professor Langbein and Judge Posner believe that social investing is undesirable because it loses money, and it does not create the change it seeks.[44] They illustrate this by using the 1980s boycott against South Africa as an example, showing the impossibility

2012.pdf (stating that as of Sept. 30, 2011, CalPERS had $1.2 billion of exposure to the alternative energy sector).

37. *Id.* at 2–3. CalPERS claims that the remaining 34% comes from CalPERS employees and members.

38. *See* Steven Malanga, *The Pension Fund That Ate California*, CITY J. (Dec. 23, 2014), http://www.city-journal.org/2013/23_1_calpers.html.

39. *See id.*

40. *See id.* Overall, CalPERS's returns have been in the bottom 1% of all large public pension funds in the past five years.

41. *See id.*

42. *Losing with Clean Tech*, WALL ST. J. (Mar. 25, 2013), http://www.wsj.com/articles/SB10001424127887324557804578374980641257340.

43. Langbein & Posner, *supra* note 9, at 94–95.

44. *Id.* at 96.

of causing change through SRI: Not only would firms with offices in South Africa have to be excluded, but also AT&T because it has phone lines there, and banks that honor South African checks, and any other business providing goods or services to that country, even indirectly.[45]

Professor Michael Knoll claims that it is impossible for nonfinancial screening to change corporate behavior while remaining costless to the investor.[46] In an efficient market, meaning one where the prices of securities accurately reflect their value, screening will prevent diversification[47] and thus increase the investor's risk.[48] In an inefficient market, screening increases the risk that the investor will exclude an undervalued security, thereby missing an opportunity for profit.[49] Additionally, Knoll argues that the demand curve for stocks is horizontal, which means that screening out a stock does not affect its demand; therefore, other investors will simply purchase the shares that the screening investor did not.[50] Like Langbein and Posner, Knoll challenges the alleged success of the South African boycott, arguing that it had no effect at all on repealing apartheid.[51]

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45. *See id.* at 87.

46. Knoll, *supra* note 10, at 710–11.

47. Diversifying securities is a method of reducing a portfolio's risk. *See* RESTATEMENT (THIRD) OF TRUSTS § 90(b) (2007) ("In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so."); Benjamin J. Richardson, *Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investing?*, 22 BANKING & FIN. L. REV. 145, 152 (2007) ("A fiduciary should avoid speculative and unduly risky investments and a diverse portfolio can minimize investment risk.").

48. *See* Knoll, *supra* note 10, at 693–98.

49. *Id.* at 700–02 (stating that though it's impossible to test, it stands to reason that "[a]dding a constraint can only hurt you.").

50. *Id.* at 706–08. Furthermore, some funds, such as the Vice Fund, purposefully invest in companies that SRI funds commonly screen out. *See, e.g.*, *Vice Fund*, USA MUTUALS, http://www.vicefund.com/ (last visited Jan. 28, 2014) ("The [Vice] Fund seeks to select well-performing stocks of tobacco, alcohol, gaming, and weapons/defense companies because we believe that these industries tend to thrive regardless of the economy as a whole.").

51. Knoll, *supra* note 10, at 710 (citing Siew Hong Teoh et al., *The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 J. BUS. 35, 63–68 (1999*See also* Robert Heinkel, Alan Kraus & Josef Zechner, *The Effect of Green Investment on Corporate Behavior*, 36 J. FIN. & QUALITATIVE ANALYSIS 431, 447 (2001) (arguing that

Though SRI may not cause social change, there is reason to believe that it is not necessarily harmful to a fund either. Just because it may reduce a portfolio's diversity, almost all of the benefits of diversification come from the first twenty stocks, so screening that allows for at least a couple dozen stocks in sufficiently varied industries will likely not handicap a fund.[52] Additionally, there can be good reasons for social screening. Its original practitioners never intended or expected their screening to alter the behavior of others.[53] Rather, SRI was a way for investors to stay true to their principles of virtue and morality.[54] Many today still screen investments for this purpose. Christian Brothers Investment Services, Inc. ("CBIS") is one example. CBIS offers investment advisory services to Catholic institutions and uses Catholic social and moral teaching to screen its investments.[55] Investors with CBIS seek to avoid contributing to, or benefitting from, investments in activities that violate the teachings of the Catholic Church, such as abortion and contraception.[56] CBIS uses SRI as one means of pursuing this goal.[57] Institutions adhering to strict moral codes often require SRI, and companies like CBIS provide them valuable services. It is situations such as this from which SRI arose and in which it remains useful today.

Many funds, however, use SRI not for the sake of virtue alone, but instead claim that screening creates profit. In spite of its own financial loss resulting from SRI, CalPERS couches its investment principles in terms of adherence to its fiduciary

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though 10% of invested funds are in SRI, that is not enough to change firms' behavior).

52. Knoll, *supra* note 10, at 697. *See also* Matthew Haigh & James Hazelton, *Financial Markets: A Tool for Social Responsibility?*, 52 J. BUS. ETHICS 59, 65 (2004) (stating that research indicates SRI funds "do not underperform their conventional counterparts."); Alicia H. Munnell, *Should Public Plans Engage in Social Investing?*, CTR. FOR RETIREMENT RES. AT BOS. COLL., at 6 (2007), *available at* http://crr.bc.edu/wp-content/uploads/2007/08/ib_7-12.pdf ("[A]n investor needs only 20–30 stocks to construct a fully diversified portfolio.").

53. *See, e.g.*, Knoll, *supra* note 10, at 692.

54. *See, e.g.*, *supra* note 20 and accompanying text.

55. CHRISTIAN BROTHERS INVESTMENT SERVICES, INC., http://www.cbisonline.com (last visited Mar. 24, 2014).

56. *Id.*

57. *Id.*

duty[58] imposed by the California Constitution[59] and the supposed financial benefits of SRI to the investor.[60] Why mention the financial benefits of investing against global warming? Is it not enough that CalPERS is taking steps to eliminate the threat?[61] No, it is not enough. For reasons explained in the next part, CalPERS has to claim that its social investing is based in profit for the fund, because otherwise such investing would be unlawful.

III. The Conflict Between SRI and Fiduciary Duties

The reason SRI is unlawful in some instances is that the person engaging in SRI may have a fiduciary duty not to so engage. This Part describes the contract theory of fiduciary duties and explains why it is the theory that most accurately describes how and why fiduciary duties arise. Then this Part explains what those duties require of fiduciaries who engage in SRI, namely trustees, investment advisers, and broker-dealers. Legislation may alter common-law fiduciary duties, and this Part highlights important instances where that has occurred with respect to SRI. Finally, this Part summarizes previous attempts to justify SRI in light of fiduciary duties, shows their flaws, and offers its own justification based on legal doctrine.

58. *See, e.g.*, CALPERS, *supra* note 36, at 2 ("CalPERS has a fiduciary duty, which is set out in the California Constitution.").

59. CAL. CONST. art. XVI § 17(a) ("The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system.").

60. *See, e.g.*, CALPERS, *supra* note 36, at 20 ("[C]limate change could reduce global GDP by as much as 20 percent by 2050."); *id.* at 22 ("Climate change could contribute as much as 10 percent to portfolio risk over the next 20 years."). Despite its insistence on SRI's economic factors, CalPERS lets down its guard a bit when talking about the BP oil spill in the Gulf of Mexico in 2010, stating that as a major investor in BP, CalPERS was concerned because "it was not *just* a matter of environmental and social responsibility but also financial concern: BP shares hit a 14-year low in the wake of the Deepwater Horizon spill." *Id.* at 24 (emphasis added).

61. This article states no opinion as to whether global warming exists or is a threat.

A. *The Nature of Fiduciary Duties*

The common law has recognized fiduciary duties since at least as far into the past as America's founding. Contemporary scholars and judges argue about whether these duties are contractual in nature. If fiduciary duties are contractual, then they do not stand in the way of parties making agreements that allow what a fiduciary duty would otherwise prohibit. As this part will show, fiduciary duties are contractual, and the arguments against contract theory collapse in the face of evidence.

1. The History and Contractual Character of Fiduciary Duties

The word "fiduciary" comes from "fiducia," the Latin word for "trust."[62] As a legal term of art, the word "fiduciary" has been used since the seventeenth century and refers to a person who acts for the benefit of another in "all matters within the scope of their relationship."[63] A fiduciary duty is one "of utmost good faith, trust, confidence, and candor owed by a fiduciary . . . to the beneficiary . . . ; a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person."[64]

Common law has recognized the fiduciary relationship for centuries.[65] Traces of it exist in the trust originating at the end of the Middle Ages. The trust's purpose was to circumvent feudal restrictions on land transfer.[66] Those restrictions prevented landholders from transferring their land by will, and

62. Benjamin J. Richardson, *Fiduciary Relationships for Socially Responsible Investing: A Multinational Perspective*, 48 AM. BUS. L.J. 597, 597 (2011). *See also* 5 THE OXFORD ENGLISH DICTIONARY 878 (2d ed. 1989) ("In Rom[an] Law *fiducia* denoted the transfer of a right to a person subject to the obligation to transfer it again at some future time or on some condition being fulfilled.").

63. BLACK'S LAW DICTIONARY 702 (9th ed. 2009) [hereinafter BLACK'S].

64. *Id.* at 581.

65. *See* Cooter & Freedman, *supra* note 13, at 1045 (stating that fiduciary relationships have been recognized in American law for over 250 years).

66. *See* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 632 (1995).

instead enforced primogeniture[67] and taxes.[68] Land was wealth in those days,[69] and people who had it often had desires for it which differed from those of their feudal lords. Rather than allowing one's death to trigger the land-transfer laws, holders of land ("settlors") could convey their real property during life to another ("trustee") who would agree to transfer that property to a person of the settlor's choice after the settlor's death.[70] The trustee's only duty in those days was to convey the land.[71] Over time, the trust evolved from a method of conveying land into a financial-management device.[72] The modern-day trustee's job is to actively manage trust assets.[73] Active management means the contemporary trustee, unlike the ancient trustee, has discretion over those assets. Along with this discretion comes the power to exploit. To protect beneficiaries from a trustee's nefarious acts, the law has developed fiduciary duties that require the trustee to act in the best interest of the beneficiaries and exercise care in managing the assets.[74]

These days, trustees are far from the only entities with fiduciary duties. Attorneys are fiduciaries to their clients; corporate directors are fiduciaries to their corporations; agents are fiduciaries to their principals; partners are fiduciaries to each other; and the list goes on.[75] The specific requirements of these duties are different depending on the relationship.[76] For

67. Primogeniture is "[t]he common-law right of the firstborn son to inherit his ancestor's estate, usu[ally] to the exclusion of younger siblings." BLACK'S, *supra* note 63, at 1311.

68. *See* Langbein, *supra* note 66, at 632.

69. *Id.*

70. *Id.* at 633.

71. *Id.* at 640.

72. *Id.* at 637.

73. *Id.* at 637–38. To illustrate the colossal growth of the trust, consider the contract between the medieval trustees who were not paid for their troubles and a modern trustee such as Wells Fargo Bank. *See also id.* at 638–39.

74. *Id.* at 642.

75. *See* Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 306–07 (1999) (citations omitted). The type of relationship that constitutes a fiduciary one may depend on the state. For example, some states consider oil field operators to be fiduciaries for owners. *See id.* at 308 n.24 (citing Fransen v. Conoco, Inc., 64 F.3d 1481, 1487 (10th Cir. 1995) (dictum) ("The unit operator's duty is fiduciary in nature.")).

76. *See* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 432–43 (1993).

example, a trustee's duty of care to a beneficiary requires "a high degree of prudence," whereas an attorney's duty of care to a client is the ordinary negligence standard.[77] That fiduciary obligations exist is certain, but there is debate about whether or not they are contractual in nature.[78] Those who adhere to the contract theory believe that all fiduciary duties are negotiable, while those who oppose contract theory argue that there are certain bedrock fiduciary duties that cannot be waived.[79] Who is correct is important for SRI because if, for example, a financial adviser's duty of care cannot be contractually altered, then that adviser may not be able to engage in SRI on behalf of a client.

Judge Frank Easterbrook and Professor Daniel Fischel are proponents of the contract theory. They say that in spite of the moralizing language found in many court opinions discussing fiduciary duties,[80] in reality the fiduciary relationship is not moral but contractual.[81] Fiduciary duties arise when certain aspects of a contractual relationship are impossible—for reasons of cost and lack of knowledge—to specify.[82] No contract can make provisions for every possible situation, and fiduciary duties arise when there is too great a distance between what parties are capable of providing for via contract and what

77. *Id.* at 423.

78. *See* Arthur B. Laby, *The Fiduciary Obligation as the Adoption of Ends*, 56 BUFF. L. REV. 99, 100 (2008) ("Scholars of fiduciary duties have divided themselves into two warring camps.").

79. *Id.* at 100–01.

80. Easterbrook & Fischel, *supra* note 76, at 439 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) ("A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.")); *see also id.* at 428 n.6 (citing Pepper v. Litton, 308 U.S. 295, 311 (1939); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)).

81. *Id.* at 427 ("Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived, and enforced in the same way, as other contractual undertakings."). *See also* Paul B. Miller, *A Theory of Fiduciary Liability*, 56 MCGILL L.J. 235, 237 (2011) (suggesting that fiduciary liability "might be better understood as an outgrowth of contract [law].").

82. *See, e.g.*, Easterbrook & Fischel, *supra* note 76, at 426 (arguing that the duty of loyalty "is a response to the impossibility of writing contracts completely specifying the parties' obligations."). "When one party hires the other's knowledge and expertise, there is not much they can write down." *Id.* "A 'fiduciary' relation is a contractual one characterized by unusually high costs of specification and monitoring." *Id.* at 427.

situations could occur.[83] Consider the following agreement: A homeowner contracts with a painter for the painter to paint the homeowner's house. This transaction is fairly simple and nearly all relevant matters and contingencies—such as paint color, payment, deadline, acts of God—can be accounted for in the contract. Now consider a contract between an investment adviser and client: The client contracts with the adviser for the adviser to invest the client's money and maximize the income. This agreement is long-term, the client may have little ability to monitor the adviser, and outcome may be a bad measure of the adviser's performance since luck could be a powerful factor.[84] Because there are so many possibilities that cannot be provided for in the contract, courts impose the fiduciary duties of loyalty and care onto the adviser as a way of allowing such an agreement to have value.[85] Ignorance makes holes in contracts—fiduciary duties fill them.

Easterbrook and Fischel use the often-cited *Meinhard v. Salmon*[86] to illustrate their point. In *Meinhard*, Salmon signed a twenty-year lease on a hotel.[87] Meinhard paid for half of the hotel's renovation and management and received a share of the profits.[88] When the lease was a few months from ending, a third party offered Salmon nearly ten times the old rent.[89] Salmon accepted the offer without first informing Meinhard.[90] The court held that Salmon had had a duty to tell Meinhard about the offer before accepting it himself.[91] Judge Cardozo claimed to base his

83. *Id.* at 426.

84. *Id.*

85. *Id.* at 426–27 ("[L]egal rules can promote the benefits of contractual endeavors in a world of scarce information and high transaction costs by prescribing the outcomes the parties themselves would have reached had information been plentiful and negotiations costless.") (citing R. H. Coase, *The Problem of Social Cost*, 3. J.L. & ECON. 1 (1960)). Note that courts consider an adviser's fiduciary duties to be codified in the Investors Advisers Act of 1940. *See infra* Part III.B.2.

86. Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).

87. *Id.* at 545.

88. *Id.* at 546.

89. *Id.*

90. *Id.*

91. *Id.* at 547 ("The very fact that Salmon was in control with exclusive powers of direction charged him the more obviously with the duty of disclosure . . . .").

opinion on a trustee's "punctilio of an honor the most sensitive,"[92] but Easterbrook and Fischel argue that the court was not driven by morality; rather, it was merely creating the contract it thought would have existed if bargaining costs had been lower.[93]

Commentators have proposed numerous theories as to how fiduciary duties arise and what they require.[94] However, contract theory is the best because it explains not only how fiduciary duties occur, but why—namely, to fill gaps in contracts.[95] Many attack the theory, but close examination of their criticisms reveals that they are based on mirages. The next few pages examine some of the most common arguments against

92. *Id.* at 546.

93. Easterbrook & Fischel, *supra* note 76, at 440.

94. *See* J.C. Shepherd, *A Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51 (1981) (describing several theories of how fiduciary duties arise). Unjust enrichment theory: "[A] fiduciary relationship exists where one person obtains property or other advantage which justice requires should belong to another person." *Id.* at 53. Commercial utility theory: "[A] fiduciary relationship will be found . . . in every situation in which the court feels it necessarqy to hold a person or a certain class of persons to a higher than average standard of ethics or good faith in the interests of protecting the integrity of a commercial enterprise." *Id.* at 56–57. Reliance theory: "[A] fiduciary relationship exists where one person reposes trust or confidence or reliance in another." *Id.* at 58. Unequal relationship theory: "[A] fiduciary relationship exists wherever there is established an inequality of footing between the parties." *Id.* at 61. Property theory: "[A] fiduciary relationship exists where one person has legal title and /or control over property or other advantage, and another is the beneficial owner thereof." *Id.* at 63. Power and discretion theory: "[A] fiduciary relationship exists where one person has: (a) the power to change the legal position of another, and (b) a discretion in the exercise of that power." *Id.* at 68. Shepherd's theory: "A fiduciary relationship exists whenever any person receives a power of any type on condition that he also receive with it a duty to utilise [sic] that power in the best interests of another, and the recipient of the power uses that power." *Id.* at 75. *See also* Laby, *supra* note 78, at 129–48 (arguing for a deontological theory based on Kantian ethics); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002) ("[F]iduciary relationships form when one party (the "fiduciary") acts *on behalf of* another party (the "beneficiary") while exercising *discretion* with respect to a *critical resource* belonging to the beneficiary.").

95. Note that there are those who admire Easterbrook's and Fischel's argument for contract theory and yet have perceived flaws in it. *See, e.g.*, Roberta Romano, *Comment on Easterbrook and Fischel, "Contract and Fiduciary Duty"*, 36 J.L. & ECON. 447, 448 (1993) (arguing that Easterbrook and Fischel failed to give a sufficiently specific "economic theory of the contractual relations to which courts could apply fiduciary labels").

contract theory, waving hands through their illusions and dispelling their clouds of confusion.

2. Debunking the Arguments Against Contract Theory

One frequent criticism of contract theory is that it does not explain the existence of core fiduciary duties that cannot be altered by contract.[96] Professor Arthur Laby describes a core duty as the fiduciary's obligation to adopt the principal's ends as the fiduciary's own.[97] Professor Robert Sitkoff says that a principal can never authorize a fiduciary to act in bad faith, thus making good faith a core duty.[98] Professor Scott FitzGibbon gives as an example of a core duty the fact that even with client consent, attorneys cannot alter their duty to avoid conflicts of interest with clients.[99] While all of these statements may be true, none of them supports the argument that fiduciary duties prevent parties from making agreements with regard to any specific behavior not otherwise illegal. Put differently, core duties do not define an agreement; rather, an agreement defines core duties.

As to Laby's point, the fiduciary's obligation to adopt the principal's ends is no different from the obligations of a party to any contract. That is, in fact, what contracts are: agreements under which one party adopts the ends of the other.[100] Recall the prior hypothetical contracts, one between an investment adviser and client and the other between a homeowner and painter.[101] The adviser adopts the client's goal of profit and the painter adopts the homeowner's objective of having the house

96. *See* Laby, *supra* note 78, at 103; Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1046 (2011) ("Committed contractarians have had difficulty explaining why the parties to a fiduciary relationship do not have complete freedom of contract to alter the terms of that relationship.").

97. Laby, *supra* note 78, at 103.

98. Sitkoff, *supra* note 96, at 1046.

99. FitzGibbon, *supra* note 75, at 322 ("[A] lawyer's duty to avoid certain conflicts of interest applies notwithstanding client consent to the conflict . . . .").

100. *See, e.g.*, BLACK'S, *supra* note 63, at 365 (defining a contract as "[a]n agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law.").

101. *See supra* note 84 and accompanying text.

painted. The reason the adviser-client contract includes default fiduciary duties is because by its nature, unlike the homeowner-painter contract, it has many gaps.[102] Default rules might apply to fill such gaps.[103] Fiduciary duties are gap-fillers whose application depends on the contract's terms and lack thereof.[104] Sitkoff's argument is similarly weak. Bad faith does not refer to specific behavior detached from any agreement.[105] Rather, "bad faith" is a generic term given substance only by the contract itself.[106] Therefore, while it may be true that a fiduciary can

102. *Id.*

103. *See, e.g.*, Valentine v. Ormsbee Exploration Corp., 665 P.2d 452, 457 (Wyo. 1983) ("'[P]arties who contract on subject matter concerning which known usages prevail incorporate into the agreement such implications if nothing is said to the contrary.'" (quoting Engle v. First Nat'l Bank of Chugwater, 590 P.2d 826, 831 (Wyo. 1979)); Olberding Constr. Co., Inc. v. Ruden, 243 N.W.2d 872, 875 (Iowa 1976) ("[W]here there is no agreement as to the amount of compensation, the law implies a promise to pay reasonable compensation." (citing Sitzler v. Peck, 162 N.W.2d 449, 451 (Iowa 1968)); Hunt v. First Nat'l Bank of Tampa, 381 So. 2d 1194, 1197 (Fla. Dist. Ct. App. 1980) (using the following guidelines to determine what result parties intended under unanticipated circumstances: reasonable interpretation preferred to unreasonable one; interpretation leading to reasonable conclusion preferred to one leading to unreasonable conclusion; interpretation leading to fair result preferred to one leading to unfair result; interpretation rendering contract valid preferred to one rendering contract invalid).

104. *See* Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 906–07 (2011) ("Fiduciary duties are clearly created by contract in that one can decide whether to be a party to a relationship that includes these duties as a default term. The fact that fiduciary duties are imposed by default rule rather than by explicit agreement should not take them out of the contractual realm, anymore than default rules are inconsistent with contracts in myriad other settings.").

105. *See* BLACK'S, *supra* note 63, at 159 (defining bad faith as "[d]ishonesty of belief or purpose . . . .").

106. *See, e.g.*, Huang v. BP Amoco Corp., 271 F.3d 560, 565 (3d Cir. 2001) (holding that the lower court's determination that defendant acted in good faith was based on that court's erroneous interpretation of the contract); Grand Light & Supply Co., Inc. v. Honeywell, Inc., 771 F.2d 672, 679 (2d Cir. 1985) ("The U.C.C. good faith provision may not be used to override explicit contractual terms.") (citing Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 138 (5th Cir. 1979)); Sawyer v. Guthrie, 215 F. Supp. 2d 1254, 1262–63 (D. Wyo. 2002) (refusing to imply, under the duty of good faith, a contractual provision requiring defendant to drill oil to prevent expiration of leases when no such provision existed); Oil Express Nat'l, Inc. v. Burgstone, 958 F. Supp. 366, 369–70 (N.D. Ill. 1997) (holding that counter-plaintiffs sufficiently stated claim for bad faith by alleging counter-defendant had broad discretion under the contract to perform certain acts and failed to perform those acts in a reasonable manner); Seidenberg v. Summit Bank, 791 A.2d 1068, 1076 (N.J.

never act in bad faith, in practice this could not prohibit an agreement from allowing any specific act since the agreement itself determines what bad faith is. As for attorneys, unless a state's attorney-ethics rules state otherwise,[107] attorneys and clients can in fact waive the prohibition against conflicts of interest.[108]

Another criticism of contract theory is that it does not adequately describe the fiduciary relationship. Laby notes that there are instances of high specification and monitoring costs where no fiduciary relationship arises,[109] as well as times where parties have drafted detailed contracts and yet courts have found fiduciary relationships anyway.[110] One example he gives of where fiduciary duties should arise—but do not—if contract theory were correct is in the case of securities brokerage.[111] However, brokers do in fact have a fiduciary duty to their clients for the duration of the transaction;[112] and when brokers act as advisers, the fiduciary duties of advisers apply to them as well.[113] As for cases where courts have supposedly found fiduciary duties despite detailed contracts—some of which explicitly disclaim fiduciary duties—none of the cases Laby cites to actually support the argument that fiduciary duties compel or forbid certain behavior in the face of a contractual provision to

Super. Ct. App. Div. 2002) (stating that the parole evidence rule does not prevent testimony regarding claims of bad faith since the purpose of the duty of good faith is "the enhanced status of the parties' reasonable expectations."). *But see* Wakefield v. N. Telecom, Inc., 769 F.2d 109 (2d Cir. 1985) (holding that plaintiff may show employer's bad faith if employer fired plaintiff to avoid paying commissions, though employment contract explicitly said commissions would only be paid if plaintiff were employed on date of payment).

107. *See, e.g.*, Judith A. McMarrow, *Rule 11 and Federalizing Lawyer Ethics*, 1991 BYU L. REV. 959, 959 (stating that state courts have traditionally "been the primary source for regulating lawyers and articulating standards of legal ethics."); Eli J. Richardson, *Demystifying the Federal Law of Attorney Ethics*, 29 GA. L. REV. 137, 140 n.2 (1994) (discussing how lawyers and judges have written attorney-ethics rules). *See also infra* Part III.C (describing how statutes can affect and erase fiduciary duties).

108. *See, e.g.*, *infra* notes 114–116 and accompanying text.

109. Laby, *supra* note 78, at 110–12 (giving examples such as securities brokerage and auditors).

110. *Id.* at 113 n.51 (citations omitted).

111. *Id.* at 111.

112. *See infra* note 161 and accompanying text.

113. *See infra* note 163 and accompanying text.

the contrary. An examination of those cases actually shows the opposite to be true. For example, in *Victory Lane Productions, LLC v. Paul Hastings, Janofsky & Walker, LLP*,[114] the plaintiffs sued their law firm for representing them while concealing from them a conflict of interest—a breach of the firm's fiduciary duty. Rather than holding that such a conflict was strictly forbidden, the court said an attorney could defend against the claim by showing that the transaction was fair, the client voluntarily entered into it, and the client fully understood its nature.[115] This principle agrees with contract theory since it would allow an attorney and client to contract around a conflict of interest.[116]

Though Laby cites the *Second Restatement of Trusts* to counter Langbein's argument that settlors can alter nearly all trust rules by trust provision,[117] a close reading shows that it does not actually claim that fiduciary duties prohibit settlors from making specific provisions which are legal in all other respects. In fact, the *Second Restatement* hurts the anti-contractarian argument rather than helps it. Laby cites section

114. 409 F. Supp. 2d 773, 775 (S.D. Miss. 2006). The alleged conflict of interest arose from the defendant having represented both the plaintiff and another party against the same third party. *Id.* The defendant was trying to collect money from the third party on behalf of both clients, but the third party had limited funds, thus making it impossible for the defendant to represent one client without detriment to the other. *Id.* at 776.

115. *Id.* at 781 (citing Tyson v. Moore, 613 So. 2d 817, 823–24 (Miss. 1992)).

116. For his proposition that courts find fiduciary duties in spite of detailed contracts that disclaim fiduciary duties, Laby also cites the following cases, though these cases do not support Laby's claim: Global Entm't, Inc. v. N.Y. Tel. Co., No. 00-CV-02959, 2000 WL 1672327, at *6 (S.D.N.Y. Nov. 6, 2000) (stating "A fiduciary duty must be separate and beyond any contractual duties"; but not stating or implying that fiduciary duties cannot be negated by contract); April Enters., Inc. v. KTTV, 195 Cal. Rptr. 421, 428 (Cal. Ct. App. 1983) (stating that joint ventures can be created by parties' conduct despite a contract labeling the relationship as something else, but not stating or implying that it is not the contract that determines parties' conduct); Singleton v. Stegall, 580 So. 2d 1242, 1244 (Miss. 1991) (stating that an attorney is bound by the duties of care, loyalty, and those stipulated by contract; however, parties in this case did not attempt to contractually waive any fiduciary duties and court does not say parties would have been prevented from doing so). *See* Laby, *supra* note 78, at 113 n.51.

117. Laby, *supra* note 78, at 119–22.

222(2)[118] and comment c(2) of section 78[119] as evidence that the duty of loyalty is non-negotiable.[120] While those sections do indeed say that a trust provision cannot relieve a trustee of liability for breaches of trust done intentionally or in bad faith, the trust instrument itself (as with contracts, as shown above) determines what bad faith is.[121] In fact, comment c of section 222(2) says that trust terms specifically allowing a trustee to engage in otherwise prohibited behavior or relieving the trustee from engaging in otherwise necessary behavior are valid.[122]

Laby cites section 174[123] for the proposition that while the duty of care can be modified, it cannot be eliminated.[124] But as with section 222(2), this does not mean that there are certain otherwise prohibited or required behaviors that cannot be waived by explicit provision in the trust. Case law shows this to

118. RESTATEMENT (SECOND) TRUSTS § 222(2) (1959) ("A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary . . . .").

119. RESTATEMENT (SECOND) TRUSTS § 78 cmt. c(2) (1959) ("[N]o matter how broad the provisions of a trust may be in conferring power to engage in self-dealing or other transactions involving a conflict of fiduciary and personal interests, a trustee violates the duty of loyalty . . . by acting in bad faith or unfairly.").

120. Laby, *supra* note 78, at 119–22.

121. *See, e.g.*, Nelson v. First Nat'l Bank and Trust Co. of Williston, 543 F.3d 432, 436–37 (8th Cir. 2008) (holding trustee acted in good faith despite holding allegedly risky stocks because the trust instrument specifically allowed trustee to hold such stocks and trustee did not act "dishonestly or with corrupt or selfish motives"); Marsh v. Greyhound Lines, Inc., 488 F.2d 278, 282–83 (5th Cir. 1974) (holding that trustee did not act in bad faith in denying appellee's disability benefits trust since the trust instrument required information establishing permanent disability and appellee failed to supply such information); *see also supra* note 106.

122. RESTATEMENT (SECOND) OF TRUSTS § 222(2) cmt. c (1959):

> If by the terms of the trust it is provided that the trustee shall not be under any duty to do or to refrain from doing an act which but for such provision it would be the duty of the trustee to do or refrain from doing, the trustee does not commit a breach of trust in doing or failing to do the act . . . .

123. RESTATEMENT (SECOND) OF TRUSTS § 174 (1959) ("The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property . . . .").

124. *See* Laby, *supra* note 78, at 121.

be true. For example, in *First National Bank of Chicago v. A.M. Castle & Co. Employee Trust*,[125] the court invoked section 174 in holding that it was a question of fact whether a bank fiduciary breached its duty by failing to honor an investor's request for asset withdrawal within the one-year limit stipulated in the trust instrument. This decision was based on the deadline in the trust, which was set by the settlor, and the settlor could have set a different deadline or no deadline.[126] It is only reasonable that a generic trust provision dissolving the duty of loyalty or care would not be upheld, because if it were then the trustee could flout all duties and there would be no trust agreement at all. Essentially, these *Restatement* provisions merely say that the trust instrument can allow the trustee any behavior[127] as long as it does so with a clear and explicit provision.

In essence, fiduciary duties are tools for filling gaps in contracts. One difference between contract theory and the anti-contractarian theories is that contract theory explains why courts fill such gaps and the others concentrate on how courts fill them.[128] Conflating the "how" with the "why" leads to the anti-contractarian mistake of believing that the existence of a gap-filling method automatically necessitates its use, even when there are no gaps to fill. But on a deep level, perhaps in some cases verging into the sub-conscience, the underlying principles guiding opposition to contract theory are not based on law, but rather on morality. Anti-contractarians take issue with the notion that contract theory reduces ethics and morals to contractual arrangement. For example, Laby dislikes the fact

125. 180 F.3d 814, 817 (7th Cir. 1999).

126. *Id. See also* Chao v. Malkani, 452 F.3d 290, 294 (4th Cir. 2006) (holding that plan administrator violated fiduciary duties by contradicting plan's "plain language"); Dunkley v. Peoples Bank & Trust Co., 728 F. Supp. 547, 563 (W.D. Ark. 1989) (holding that trustee breached duty of care by making distributions in violation of the trust instrument, but stating that those distributions could have been lawful had the trust instrument said so). *But see A.M. Castle*, 180 F.3d at 817 (stating in dicta that an emergency situation could have given the bank the right to breach the one-year deadline if adherence to the deadline "would have made the investors as a whole worse off . . . .").

127. This excludes behavior against public policy, i.e., illegal behavior outside the realm of fiduciary duties. For example, a trust provision directing a trustee to invest in illegal drugs would be unenforceable.

128. *See, e.g.*, *supra* note 94.

that contract theory suggests there is nothing "unique or special" about fiduciary duties.[129] (Incidentally, Easterbrook and Fischel agree with Laby on this entirely.[130]) But why would it be desirable for fiduciary duties to be "special" and what would that even mean?[131] Likely, anti-contractarians are bothered by the fact that when the frills of moral finery are stripped away, mankind's fundamental goal of efficient economic gain is exposed, making contract-theory uncomfortably honest. But honesty is itself a virtue, and when it comes to fiduciary duties, being honest about what they are makes it easier for people to contract for what they want, like SRI.

B. *What Fiduciary Duties Require of Trustees, Investment Advisers, and Broker-Dealers*

This part concerns three types of fiduciaries who might engage in SRI on behalf of another: trustees, investment advisers, and broker-dealers.[132] The fiduciary duties of each come from different sources and their requirements vary depending on the fiduciary's activity. To determine how each type of fiduciary can perform SRI without breaching their duties, these duties must be defined.

129. Laby, *supra* note 78, at 109.

130. Easterbrook & Fischel, *supra* note 76, at 438 (stating that scholars looking for a non-economic explanation for fiduciary duties cannot find one because "[t]hey are looking for something special about fiduciary relations. There is nothing special to find.").

131. Maybe the confusion stems, as Langbein suggests, from the fact that trusts originated in courts of equity rather than in courts of common law, where contract law developed. Langbein, *supra* note 66, at 632–49. Langbein explains that trusts were kept in courts of equity because common-law courts were not fact-finding and did not allow testimony. *Id.* at 635–36. This also helped to hide from the king the revenue he was missing as a result of his subjects avoiding the feudal land laws. *Id.* at 634 n.41. However, given the many years that have passed since the merging of courts of law and equity, this is unlikely the source of modern-day puzzlement. *See* Eric J. Hamilton, Note, *Federalism and the State Civil Jury Rights*, 65 STAN. L. REV. 851, 861 (2013) (claiming that states began merging their courts of law and equity in the mid-19th century, though 4 states—Deleware, Mississippi, New Jersey, Tennessee—still maintain separate courts).

132. Note that with regard to finance committee members and directors of entities, if they operate under a trust instrument then their duties, powers, and abilities to engage in SRI when investing trust funds are analyzed under the same rules as those of trustees.

1. Trustees

A trustee is a person who holds legal title to property for the benefit of another person.[133] Trustees have two general fiduciary duties: care and loyalty.[134] These duties exist to ensure trustees put their best effort into managing the trust and do so with the objectives of the trust in mind.[135] The duty of care requires trustees to follow the Prudent Investor Rule.[136] This rule imposes on trustees the duty to invest and manage the assets of the trust as would a prudent investor.[137] As mentioned, this includes a duty to diversify investments unless diversification would be unwise.[138] Trustees must carefully investigate opportunities and relevant information before making a decision, and have reasonable grounds for whatever decision they make.[139] Trustees who hold themselves out as having special expertise in the area of finance and investments must use this expertise in managing their trusts.[140] Trustees may delegate trust-management tasks to third parties, but they must

133. *See* BLACK'S, *supra* note 63, at 1656.

134. *See, e.g.*, *supra* note 13.

135. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007) ("The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives."); *id.* § 78(1) ("Except as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely in the interest of the beneficiaries . . . .").

136. The Prudent Investor Rule governs the investment of trust funds, and its roots can be traced back to *Harvard College v. Amory*. 26 Mass. (9 Pick.) 446 (1830). *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 717 n.94 (2010) [hereinafter *Fiduciary Obligations*]. *Amory* said that trustees should manage their trust as would a prudent man, "not in regard to speculation, but in regard to the permanent disposition of their funds . . . ." 26 Mass. (9 Pick.) at 461. This came to be known as the Prudent Man Rule. *See* RESTATEMENT (THIRD) OF TRUSTS pt. 6, ch. 17, intro. note (2007). However, the Prudent Man Rule's classification of certain categories of investments as "speculative," and thus imprudent, caused increasing criticism of the Rule. *See id.* In response to these criticisms, the Prudent Investor Rule arose "to modernize trust investment law and to restore the generality and flexibility of the original doctrine." *Id.*

137. RESTATEMENT (THIRD) OF TRUSTS § 90 (2007).

138. *See supra* note 47.

139. *See* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007).

140. *Id.* ("[I]f the trustee possesses a degree of skill greater than that of an individual of ordinary intelligence, the trustee is liable for a loss that results from failure to make reasonably diligent use of that skill.").

act prudently in delegating authority and choosing and monitoring such agents.[141] The unifying purpose of these aspects of the duty of care is to maximize the financial performance of the trust in accord with the trust's provisions and stated purpose.[142]

The duty of loyalty requires trustees to manage their trusts in the sole interests of the beneficiaries.[143] Thus, unless authorized by the trust instrument or a court, trustees may not themselves deal with the trust.[144] This prohibition is so strict that, even if a trustee can demonstrate that such a transaction was done in good faith, under fair terms, and without profit to the trustee, the trustee will still have breached the duty of loyalty.[145] Naturally, this duty also prohibits the trustee from administering the trust in the interest of non-beneficiaries,[146] which is particularly relevant with regard to SRI.

2. Investment Advisers

Investment advisers are regulated by the federal Investment Advisers Act of 1940 ("IAA").[147] This was the final act in a series passed to regulate the securities industry and prevent behavior Congress considered to have contributed to the 1929 stock market crash and the Great Depression.[148] The IAA defines an investment adviser as a person who, for compensation, advises others as to the value or advisability of investing in securities.[149] Sections 206(1) and (2) prohibit

141. *Id.* § 90(c)(2).

142. *Id.* pt. 6, ch. 17, intro. note (2007) (explaining how the rise of modern portfolio theory engendered the more flexible Prudent Investor Rule so as to better take advantage of modern investment techniques and theories).

143. *Id.* § 90 cmt. c.("The strict duty of loyalty . . . prohibits the trustee from investing or managing trust investments in a manner that will give rise to a personal conflict of interest.").

144. *See id.* § 78(2).

145. *Id.* § 78 cmt. b (explaining the "no further inquiry" principle).

146. *Id.* § 78 cmt. f ("[T]he trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.").

147. Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–21 (2012).

148. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

149. 15 U.S.C. § 80b-2(a)(11).

investment advisers from defrauding or deceiving clients or prospective clients.[150] Section 206(3) requires the adviser to inform clients of when their purchase or sale of a security will benefit the adviser's own account or the account of another client of the adviser.[151] The first case to interpret Sections 206(1) and (2) of the IAA was *SEC v. Capital Gains Research Bureau, Inc*.[152] This case is often cited for the proposition that the IAA imposed a fiduciary duty on financial advisers, and the SEC still relies on it in enforcement actions.[153]

Capital Gains appeared to follow trust law in its analysis of the adviser's duties.[154] Like a trustee to a beneficiary, the financial adviser must act in the best interest of the client.[155] Part of acting in the client's best interest is fully disclosing all actual and potential conflicts of interest to the client.[156] Much of

150. *Id.* § 80b-6(1) & (2).

151. *Id.* § 80b-6(3).

152. 375 U.S. 180 (1963)..

153. *See* Arthur B. Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940*, 91 B.U. L. REV. 1051, 1052–53 (2011). Laby argues that *Capital Gains* did not actually hold that the IAA created a fiduciary duty for advisers; rather, subsequent cases "misread or simply disregarded" *Capital Gains*. *Id.* at 1053. Rather than holding that the IAA created a fiduciary duty for advisers, Laby argues the Court believed that Congress recognized such a duty existed before the IAA. *Id.* at 1066. Though *Capital Gains* never said that the IAA created fiduciary duties, *Santa Fe Indus. v. Green*, 430 U.S. 462, 471 n.11 (1977) claimed that *Capital Gains* did just that. However, the IAA never describes advisers as fiduciaries, and previous versions of that Act which did were voted down. *Id.* at 1069–70. According to Laby, there are three consequences to this fiduciary standard that originated in the Court (specifically, footnote 11 in *Santa Fe*): (1) all financial advisers are now considered fiduciaries, whereas in the past an adviser's fiduciary status depended on the nature of the relationship with the client; (2) the law governing advisers is vaguer than the law banning fraud; and (3) there is an issue as to which governing body can change the law now that it is established. *Id.* at 1080–1103. However, given that this federal fiduciary duty is now firmly established for advisers, going beyond noting the duty's questionable pedigree is beyond the scope of this article.

154. *See, e.g.*, Laby, *Fiduciary Obligations*, *supra* note 136, at 717 n.94 ("The principles of loyalty and care espoused in *Capital Gains Research Bureau* are cornerstones of the so-called 'Prudent Investor Rule,' . . . .").

155. *See, e.g.*, SEC v. Tambone, 550 F.3d 106, 146 (1st Cir. 2008) ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund and its investors . . . ."), *vacated en banc*, 573 F.3d 54 (1st Cir. 1992).

156. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 192 (1963) (stating that the IAA showed Congress's intent to eliminate or expose

the litigation against advisers for violating Sections 206(1) and (2) of the IAA is a result of advisers not telling their clients about such conflicts.[157] Advisers also must ensure that the securities they recommend are appropriate for each client in terms of the client's financial situation and aspirations.[158] This entails examining each client's circumstances and having a reasonable basis for recommendations.[159]

3. Broker-Dealers

A broker-dealer is any person engaged in the business of effecting transactions in securities.[160] For the duration of that transaction, broker-dealers have a fiduciary duty to their clients to ensure the transaction is executed.[161] But whether a broker-dealer's fiduciary duties go beyond the bounds of that transaction can be uncertain.[162] This is because the relationship of broker-dealers to their clients is not always clear. The IAA does not apply to broker-dealers if their performance of advisory services is "incidental" to their broker services and if they receive

all conflicts of interest that could motivate an adviser to render non-disinterested advice).

157. *See, e.g.*, SEC v. Gabelli, 653 F.3d 49, 52–53, 61 (2d Cir. 2011) (granting injunction against advisers who violated the IAA by failing to disclose to clients that the advisers allowed one client to engage in "market timing," an advantage not given to the other clients), *rev'd on other grounds*, 133 S. Ct. 1216 (2013); Vernazza v. SEC, 327 F.3d 851, 858–59 (9th Cir. 2003) (holding advisers violated IAA for failing to disclose to clients the advisers' own interest a certain fund adviser recommended); SEC v. Bolla, 401 F. Supp. 2d 43, 73 (D.D.C. 2005) (holding that adviser violated IAA for misleading clients about the barred status of a co-member of firm).

158. *See* Laby, *Fiduciary Obligations*, *supra* note 136, at 719 (citing Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Advisers Act Release No. 1406, 59 Fed. Reg. 13,464 (Mar. 16, 1994)).

159. *Id.*

160. *See* 15 U.S.C. § 78c(a)(4) & (5) (2012).

161. *See* Laby, *Fiduciary Obligations*, *supra* note 136, at 725 ("Although courts impose fiduciary duties on brokers administering non-discretionary accounts, those duties last only for the narrow window when the broker is executing a transaction." (citing Limbaugh v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 732 F.2d 859, 862 (11th Cir. 1984)).

162. *Id.* at 719 ("Fiduciary law governing broker-dealers is more ambiguous than the law that governs advisers.").

"no special compensation" for such incidental advising.[163] It seems to be saying that broker-dealers are not subject to the IAA unless they are advisers. But could this not be said about anyone? After all, the IAA does not apply to truck drivers either unless they are also financial advisers, but the IAA does not talk about truck drivers. Why does the IAA even mention broker-dealers? The answer is found in history.

Modern computer technology makes selling securities easy, but in the 1930s such a transaction was a complex process requiring the professional services of brokers and dealers.[164] Brokers bought and sold securities for their clients directly through the market.[165] Dealers did the same but from the dealer's own account rather than out in the market.[166] Because a broker dealt with the securities of third parties on behalf of the client, the Securities Exchange Act of 1934 imposed the fiduciary duty of loyalty onto brokers, but not dealers.[167] This duty only lasted for the time the broker had custody of the client's funds.[168] Six years later, Congress enacted the IAA and wanted to distinguish advisers from brokers and dealers since the two latter were merely "arm's-length" salesmen, in contrast to advisers, who gave investment advice to unsophisticated investors on the premise that advisers had special knowledge.[169] Technological advances have reduced the need for professionals who exist merely to facilitate securities transactions, thus lowering demand for the traditional broker and dealer functions.[170] These changes forced brokers and dealers to market themselves as having advisory skills, so that nowadays it is brokerage that is incidental to advice, not the other way

163. 15 U.S.C. § 80b-2(a)(11)(C).

164. *See* Nicholas S. Di Lorenzo, Note, *Defining a New Punctilio of an Honor: The Best Interest Standard for Broker-Dealers*, 92 B.U. L. REV. 291, 307–08 (2012) (describing the complexity of Depression-era trade execution and how technological advances have simplified the process).

165. *Id.* at 301.

166. *Id.*

167. *Id.*

168. *See* Laby, *Fiduciary Obligations*, *supra* note 136, at 721.

169. *See* Di Lorenzo, *supra* note 164, at 301.

170. *See id.* at 303; *see also id.* at 307–08 (explaining that in the 1930s and prior, trade execution was a complex process and thus a "vital function" of brokerage firms).

around.[171] The modern approach in determining if a broker-dealer is a fiduciary is to look at factors such as the client's sophistication, how often the client follows the broker-dealer's advice, and the broker-dealer's discretion over the client's money.[172]

It is arguable that there is evidence of a movement to apply the fiduciary duties of financial advisers to all broker-dealers. Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) directs the SEC to study how effective current regulation of broker-dealers is in protecting consumers,[173] as well as the impact of eliminating the broker-dealer exception from the IAA.[174] Dodd-Frank purportedly gives the SEC authority to establish a fiduciary duty applicable to broker-dealers equal to the duty of investment advisers.[175] In substance though, this authority does not amount to anything more than what already existed. Dodd-Frank only permitted the SEC to equalize the standards of broker-dealers and investment advisers with regard to broker-dealers who give "personalized investment advice."[176] The SEC has suggested that it may use its new authority to require such broker-dealers to document the basis for their belief that their advice is in the client's best interest.[177] But since Dodd-Frank limits the SEC's authority to establishing fiduciary duties for broker-dealers only if they advise clients, it is hard to see how this is anything new given the fact that broker-dealers who also advise are covered under the IAA anyway.[178] For now, broker-dealers can avoid the

171. *See* Laby, *Fiduciary Obligations*, *supra* note 136, at 737.

172. *See id.* at 723 (noting that whether an account is discretionary is usually determinative).

173. 15 U.S.C. § 78o note (2012); H.R. 4173 § 913(b)(1) (2010).

174. 15 U.S.C. § 78o note; H.R. 4173 § 913(c)(10).

175. 15 U.S.C. § 78o note; H.R. 4173 § 913(g).

176. *See supra* note 175.

177. *See* INVESTOR ADVISORY COMMITTEE, SEC, DRAFT RECOMMENDATION OF THE INVESTOR AS PURCHASER SUBCOMMITTEE: BROKER-DEALER FIDUCIARY DUTY 8 (2013), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation.pdf.

178. *See, e.g.*, Donald C. Langevoort, *Psychological Perspectives on the Fiduciary Business*, 91 B.U. L. REV. 995, 996 (2011) ("[Dodd-Frank] insists on conjoining the fiduciary responsibilities of brokers and advisers, but then explicitly sets forth limitations on SEC rulemaking relating to the sale of proprietary products and continuing duties of care, clearly showing Congress

fiduciary duties of advisers by refraining from giving personalized advice.[179]

C. *How Legislation May Alter Fiduciary Duties*

Dodd-Frank and the IAA are not the only examples of legislation affecting fiduciary duties. Other examples are Connecticut's code specifically allowing the state treasurer to engage in SRI with respect to the state's trust funds,[180] as well as state-specific trustee duties.[181] Though not legislation, codes of ethics governing the relationship between attorneys and clients also affect fiduciary duties.[182] Probably the most relevant statute in terms of breadth of applicability is the Employee Retirement and Income Security Act ("ERISA").[183] The purpose of ERISA is to protect beneficiaries of private pension plans.[184] ERISA imposes a prudent-man standard of care on trustees of such pension plans, requiring them to manage the plan "solely" in the interest of its beneficiaries.[185] The ERISA duties are among "the highest known to the law."[186] Pension-fund

expected something short of true fiduciary responsibility.").

179. *See* INVESTOR ADVISORY COMMITTEE, *supra* note 177, at 6 ("[Broker-dealers] who wish to avoid regulation under the Advisers Act could do so by limiting themselves to transaction-specific recommendations while avoiding holding themselves out as advisers or as providing advisory services.").

180. CONN. GEN. STAT. § 3-13d(a) (2014) ("Among the factors to be considered by the Treasurer with respect to all securities may be the social, economic and environmental implications of investments of trust funds in particular securities or types of securities.").

181. *See generally* John Langbein, *Why Did Trust Law Become Statute Law in the United States?*, 58 ALA. L. REV. 1069 (2007) (explaining how the development of the trust from a land-transfer tool into a wealth-management device prompted development in trust law to move from common law to statutory, such as the Uniform Trust Code).

182. *See supra* note 107 and accompanying text.

183. Employee Retirement Income Security Act, 29 U.S.C. §§ 1001–1461 (2012).

184. *See id.* §§ 1001a(c)(3), 1001b(c)(3). ERISA does not apply to government-employee pension plans. *Id.* § 1003(b)(1). As of the end of 2011, private U.S. retirement plan assets totaled about $13.5 trillion. *See FAQs About Benefits—Retirement Issues*, EMPLOYEE BENEFIT RESEARCH INST., http://www.ebri.org/publications/benfaq/index.cfm?fa=retfaq4 (last visited Mar. 24, 2014).

185. 29 U.S.C. § 1104(a).

186. Gary J. Caine, FSA, *ERISA Fiduciary Responsibility: Fiduciary*

fiduciaries must either perform their duties to the standard of an informed investor (not a layman),[187] or hire someone who can.[188]

This "exclusive benefit rule" of ERISA—so called because of the requirement that pension-fund trustees operate "solely" in the interest of plan beneficiaries[189]—has been criticized. Professors Fischel and Langbein point out the fact that unlike with normal trusts where there is a clear distinction between settlor and beneficiaries, in employee-pension trusts both the employee and employer can be considered settlors and beneficiaries.[190] This is because often they both pay into the fund and both benefit from it in the form of tax advantages.[191] Providing for the sole benefit of beneficiaries is further complicated by the fact that there is often a conflict of interest between younger and older workers since the plan benefits older workers more than the younger ones in the present, and ERISA gives no guidance on how to deal with this.[192]

Despite its flaws, most seem to agree—and it stands to reason—that the exclusive-benefit rule forecloses any opportunity for SRI since pension funds must be managed only in the interests of beneficiaries, not in the interest of society at large.[193] This holds true even if the trust instrument provides

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Reliance on Registered Investment Advisors, at 1, *available at* http://multnomahgroup.com/pages/wp-content/uploads/2012/02/White-Paper-Fiduciary-Reliance-on-RIAs.pdf (last visited May 22, 2015) (quoting Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982)).

187. 29 U.S.C. § 1104(a)(1)(B).

188. *See* Caine, *supra* note 186, at 1 (citing DOL Reg. § 2509.95-1(c)(6)); *see also supra* note 141 and accompanying text (regarding the Prudent Investor Rule's standard for delegation of trustee duties).

189. *See supra* note 185; *infra* note 193.

190. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1117–18 (1988).

191. *See id.*

192. *See id.* at 1120 n.60.

193. *See id.* at 1147 ("A principal reason most of the pressures for social investing in recent years have been directed at ERISA-exempt funds, such as state and local pension plans and university and other charitable endowments, is that . . . the perception has been that the exclusive benefit rule forecloses the issue."); *see also* 29 C.F.R. § 2509.08-1 (2015) ("ERISA's fiduciary standards expressed in sections 403 and 404 do not permit fiduciaries to select investments based on factors outside the economic interests of the plan until they have concluded, based on economic factors, that alternative investments

otherwise.[194] Though the U.S. Department of Labor ("DOL"), in a letter to Calvert Investments, Inc., said that ERISA fiduciaries may engage in SRI, the DOL qualified this by stating that an investment under ERISA made on the basis of non-economic factors is permissible only if that investment, "when judged solely on the basis of its economic value, would be equal or superior to alternative available investments."[195] This statement cannot be read to mean the DOL construes ERISA to permit SRI. Rather, it means the opposite. Obviously, an investment that is superior to all others—or not inferior to any others—based on economic factors would not put a trustee in danger of violating fiduciary duties. What the DOL is really saying here is that trustees of ERISA plans must place economic criteria above all other factors when making investment decisions.

However, SRI may be permissible in an ERISA plan where the plan provides participants with individual accounts and those participants exercise control over the assets in those accounts.[196] In such an instance, ERISA does not consider the participant or trustee to be fiduciaries; therefore, ERISA's fiduciary duties would not apply to them.[197] Statutes like ERISA might make it easy to determine if SRI is allowed, but what about where legislation is silent?

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are equal."). Moreover, Congress rejected several proposed ERISA provisions designed to encourage SRI. *See* Hutchinson & Cole, *supra* note 15, at 1365. *But see* Ronald B. Ravikoff & Myron P. Curzan, *Social Responsibility in Investment Policy and the Prudent Man Rule*, 68 CALIF. L. REV. 518, 531–36 (1980) (arguing for a broad reading of ERISA that allows for trustees to "incorporate nontraditional objectives" into investment decision making).

194. 29 U.S.C. § 1104(a)(1)(D) (stating that the trustee must act according to the "documents and instruments governing the plan insofar as such documents and instruments are consistent with [the statute].").

195. Letter from Robert J. Doyle, Director, Office of Regulations & Interpretations, U.S. Department of Labor, to William M. Tartikoff, Senior Vice President and General Counsel, Calvert Group Ltd. (May 28, 1998), *available at* http://www.dol.gov/ebsa/programs/ori/advisory98/98-04a.htm. *See also* Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61,734 (Oct. 17, 2008) ("[B]efore selecting an [ETI], fiduciaries must have first concluded that the alternative options are truly equal.").

196. 29 U.S.C. § 1104(c)(1)(A).

197. *Id.* § 1104(c)(1)(A)(i)–(ii). 29 C.F.R. § 2550.404C-1 describes the conditions where this ERISA exemption exists.

D. *The Effect of Fiduciary Duties on SRI*

Without a statute specifically allowing or mandating SRI, legal scholars had generally been of the view that SRI violates a fiduciary's duties.[198] However, in 2005 the United Nations Environment Program Finance Initiative[199] commissioned the law firm of Freshfields Bruckhaus Deringer to determine whether the law prohibits, permits, or requires SRI.[200] The Freshfields report said that SRI is necessary in two situations: when social factors materially impact the financial performance of an investment, or when there is a consensus among the fund's beneficiaries that social factors should have weight in investment decisions.[201] Further, trustees may use SRI as a tie-breaker when all other criteria involved in an investment decision are equal.[202] Many consider this report to have settled the issue of whether SRI conflicts with fiduciary duties.[203] But

198. *See* Joakim Sandberg, *Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective*, 101 J. BUS. ETHICS 143, 144 (2011).

199. The "UNEP FI is a global partnership between UNEP and the financial sector." UNEP FINANCE INITIATIVE, www.unepfi.org (last visited Dec. 13, 2013). The UNEP was established in 1972 and "is the voice for the environment within the United Nations system. UNEP acts as a catalyst, advocate, educator and facilitator to promote the wise use and sustainable development of the global environment." *About*, UNEP FINANCE INITIATIVE, www.unep.org/About/ (last visited Dec. 8, 2013).

200. UNEP FINANCE INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 6 (2005), *available at* http://www.unepfi.org/fileadmin/documents/freshfields_legalresp_20051123.pdf.

201. *Id.* at 14.

202. *Id.*

203. *See e.g.*, Sandberg, *supra* note 198, at 144 (stating that whether fiduciary duties allow for SRI is "an issue largely considered to be settled by the Freshfields report."). Professor James Hawley of St. Mary's College of California said this about the Freshfields report: "[I]t essentially flip-flops the conventional wisdom on fiduciary duty, completely turning it on its head . . . [and] the fact that this report was prepared by Freshfields—the third largest firm in the world, well known as a corporate fiduciary firm—carries huge clout." William Baue, *Fiduciary Duties Redefined to Allow (and Sometimes Require) Environmental, Social and Governance Considerations*, SUSTAINABLE INV. NEWS (Nov. 3, 2005), http://dev.socialfunds.com/news/article.cgi/article1851.html. However, turning centuries' worth of wisdom on its head does not necessarily result in greater wisdom, and while the fact that Freshfields is a large firm may render its report influential, it does not make it correct.

the truth is that Freshfields's conclusions were based on a misunderstanding of SRI and a misreading of case law.

First, as said above, an investment made on the basis of financial concerns is not SRI.[204] Therefore, when Freshfields said that a fiduciary must perform SRI when social factors affect the investment's financial performance, Freshfields was not actually talking about SRI at all. Second, Freshfields's notion of consensus among beneficiaries is unrealistic. Social issues tend to be controversial, and it would be nearly impossible for all beneficiaries to agree with each other on any of them.[205] Freshfields acknowledged this difficulty[206] and suggested that fiduciaries can look to "clear breaches of widely recognized norms" in lieu of proof of consensus.[207] But such norms have nothing to do with beneficiary consensus, and this solution merely raises the question of how these norms can be recognized.[208] Finally, the idea that SRI could be a tie-breaker when investment options are otherwise equal is also a fantasy. As Professor Joakim Sandberg has argued, it is almost impossible for two options to be indistinguishable.[209] If options do appear to be identical, then this is probably an indication that more research is necessary to discover differences.[210] And in the event that there are two equal choices, a prudent investor would likely invest in both to mitigate hidden risk.[211]

Though Freshfields cites cases in support of its thesis that SRI is not in conflict with fiduciary duties, Freshfields's

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204. *Supra* Part I.A.

205. *See, e.g.*, Sandberg, *supra* note 198, at 153 ("[I]t is extremely unlikely that there is a single [SRI] issue on which all beneficiaries can agree.").

206. UNEP FINANCE INITIATIVE, *supra* note 200, at 12 ("There are clear practical difficulties involved in identifying such a consensus by empirical means.").

207. *Id. See also id.* at 96.

208. Freshfields gave "conventions on the elimination of child labor" as an example of how to determine a widely recognized norm, *id.*, but not only does such a convention have nothing to do with beneficiary consensus, it is absurd to suggest that a resolution from an international convention means there can be no disagreement on the resolution's conclusion, especially since if there actually were no disagreement then there would not have been a need for the resolution.

209. *See, e.g.*, Sandberg, *supra* note 198, at 149.

210. *Id.*

211. *Id.*

interpretation of those cases is contrived. Freshfields cites *Withers v. Teachers' Retirement System of the City of New York*[212] for the proposition that trustees can make "imprudent" investments as long as they are in the long-term best interests of the beneficiaries.[213] But *Withers* does not hold that bad investment decisions are actually good if they are in the beneficiaries' long-term interests, and the case certainly does SRI proponents no favors. In *Withers*, pension-fund trustees invested in city bonds for the purpose of preventing the city's bankruptcy.[214] The city was the main source of the fund's income, and its bankruptcy would have rendered the fund insolvent within a decade.[215] The plaintiffs alleged the trustees breached their fiduciary duty by investing in these unmarketable bonds,[216] but the court found that since the trustees had "firm grounds for believing" the bond investments were the only means of preventing exhaustion of the fund's assets, their decision to invest in those bonds was prudent.[217]

This is a far cry from, for example, CalPERS making an investment in green energy with the expectation that climate change could reduce global GDP by twenty percent in the next thirty-five years.[218] Consider the drastic difference: In *Withers*, there was a direct and easily discernible connection between the investment in city bonds and the survival of the pension fund, whereas investing in a company based on the financial effect of its environmental policy requires two elements which are nearly impossible to obtain. First, that company's policy must have a demonstrable effect on the condition of the environment; and second, that effect must itself have a demonstrable effect on that same company's financial performance.[219] Otherwise, the notion

212. 447 F. Supp. 1248 (S.D.N.Y. 1978).

213. UNEP FINANCE INITIATIVE, *supra* note 200, at 96; *see also id.* at 112 n.460 ("[*Withers*] supports the view that [SRI] considerations can be taken into account in assessing the likely implications and consequences of an investment.").

214. *Withers*, 447 F. Supp. at 1250.

215. *Id.* at 1251–52.

216. *Id.* at 1254.

217. *Id.* at 1259.

218. *See, e.g.*, *supra* note 60.

219. To see why this would be almost impossible to prove, consider first how long it can take for a company's behavior to cause an observable change in the environment. Second, even if there were such a change, how could its

that such an investment is based on financial return is rooted in nothing but dreams.

Only one of the cases Freshfields cited has anything to do with SRI: *Board of Trustees v. Mayor of Baltimore City*.[220] This illuminates perhaps the main reason for the lack of legal analysis in nearly all commentary about the relationship between SRI and fiduciary duties: There is almost no case law on it.[221] And rather than supporting Freshfields's thesis, *Board of Trustees* is a striking example of the conflict between fiduciary duties and SRI. During the American uproar over South African apartheid,[222] the city of Baltimore enacted an ordinance requiring city-employee pensions to divest holdings in companies doing business in South Africa and stipulated that those companies would be determined by a list created by a private organization.[223] Pension-fund trustees sued the city,

cause be traced to any particular company when there are so many companies whose environmental effects can spread across vast distances? Third, even if such a change could be traced to a specific company's behavior, how could this change's effect on that company's financial performance possibly be measured? *See, e.g.*, Hutchinson & Cole, *supra* note 15, at 1369 (stating that the argument that a stronger local economy or freer society will benefit pension-plan participants is a "tenuous link," making it difficult to determine whether the purpose of the investment was to benefit the participants or to achieve some other purpose). However, there are others besides CalPERS and Freshfields that would claim the link between climate change and a company's finances is not too tenuous for a fiduciary's consideration. For example, Bill McKibben argues that fossil-fuel companies have "five times as much oil and coal and gas on the books as climate scientists think is safe to burn." Bill McKibben, *Global Warming's Terrifying New Math*, ROLLING STONE (July 19, 2012), http://www.rollingstone.com/politics/news/global-warmings-terrifying-new-math-20120719. Since this inventory is accounted for in the value of the companies' stocks, if the government were to prevent the excess fuel from being burned, the value of those stocks would drop. *Id.* But even if government took such action, it would not be accurate to say the reduction in the companies' values resulted from climate change; rather, governmental action would be the cause.

220. 562 A.2d 720 (Md. 1989).

221. *See, e.g.*, Richardson, *supra* note 20, at 271 (stating that there is little U.S. case law on SRI because SRI "hardly challenges the economic values that underpin fiduciary norms").

222. *See, e.g.*, *supra* Part I(B).

223. *Bd. of Trs.*, 562 A.2d at 724. Specifically, the statute said the companies would be identified by reference to the annual report of the Africa Fund. *Id.* The trustees challenged this list in court, arguing that it impermissibly delegated legislative power to the Africa Fund. *Id.* at 730. The court got around this by holding that the list was merely a reference, but the

arguing that the ordinance prevented them from fulfilling the city's duty to prudently manage the plan.[224] The court held the ordinance did not force the trustees to violate their duties, though the court had to twist its rationale around the rock-solid fact that the ordinance prevented the trustees from optimizing investments. For example, the court said the ordinance would not jeopardize the amount of payment to beneficiaries of the fund.[225] However, this is false since the ordinance banned investments in many large companies.[226] The court also discounted the trustees' argument that considering social factors unrelated to investment performance altered their duty of prudence, though the court cited no actual law in support of its holding.[227]

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ordinance stated that the companies doing business in or with South Africa "*shall* be identified by reference . . ." to the list. *Id.* (emphasis added). *See also* Garrett M. Smith, *Board of Trustees v. City of Baltimore: Public Pension Fund Divestment of South African Securities Upheld*, 49 MD. L. REV. 1030, 1040–41 (1990) (stating that the court failed to determine if the list was in fact non-binding and instead merely said it should construe the ordinance so as to be unconstitutional). Though the issue of the list has nothing to do with SRI, it is one more example of the opinion's addled rationale and a hint that this holding was driven by a search for particular results rather than adherence to the law.

224. *Bd. of Trs.*, 562 A.2d at 733–35. The court and parties termed the city's duties contractual, not fiduciary. Thus, the trustees argued that the ordinance "unconstitutionally impairs contractual obligations. . . .." *Id.* at 733. However, the court and parties agreed that these contractual duties included the common-law fiduciary duties of prudence and loyalty. *Id.* at 734. The trustees argued that the ordinance altered their duty of prudence "by radically reducing the universe of eligible investments." *Id.* at 735.

225. *Id.* ("[D]ivestiture does not imprudently increase risk or decrease income.").

226. *Id.* ("While the Ordinances seem to ban investments in many larger companies with a high market capitalization, numerous opportunities remain available.").

227. The court cited 3 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 227.17 (4th ed. 1988) for the proposition that trustees do not need to get maximum return and can perform SRI. *Bd. of Trs.*, 562 A.2d at 736. Though this treatise does in fact say just that—"Trustees in deciding whether to invest in, or to retain, the securities of a corporation may properly consider the social performance of the corporation"—it cites no law in support of its argument. SCOTT & FRATCHER § 227.17. Rather, it merely analogizes a trustee's duties to a corporation's ability to contribute to charity. *Id.* Furthermore, the succeeding edition of that treatise recanted its claim that SRI is permissible without authorization in the trust instrument. *See* 4 AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER, & MARK L. ASCHER, SCOTT ON TRUSTS § 19.1.13 (5th ed. 2007).

In sum, a close reading of the cases Freshfields cited to support its conclusion that SRI does not violate fiduciary duties shows that the opposite is the truth. Trustees cannot lawfully engage in SRI because their fiduciary duty of care, which holds them to the Prudent Investor Rule,[228] and their fiduciary duty of loyalty, which requires them to invest only for the benefit of the beneficiaries, both prevent SRI.[229] Advisers and broker-dealers acting as advisers cannot engage in SRI because of their fiduciary duty to act in the best interest of the client and to ensure appropriateness.[230] But, as shown above,[231] fiduciary duties are contractual in nature and subject to agreement. Therefore, SRI will not violate fiduciary duties as long as the settlor stipulates it or the parties agree to it. They can do this through the doctrine of authorization. In some instances, ratification or exculpation clauses also allow SRI.

IV. Lawful Methods of Performing SRI

Trust law has two doctrines that can allow the trustee to engage in SRI: authorization and ratification.[232] Additionally, exculpation clauses in a trust document or contract may permit SRI. Authorization occurs when the trust instrument explicitly allows the trustee to engage in specific behavior.[233] Ratification occurs when trust beneficiaries consent to the trustee's act or omission, thus rendering the trustee not liable.[234] Exculpation clauses are provisions in trusts or contracts that eliminate a trustee's or adviser's liability for certain behavior.[235] Given the contractual nature of fiduciary duties,[236] advisers and broker-dealers who advise can integrate the principle of authorization

228. *See supra* Part III.B.1.

229. *See id.*

230. *See supra* Part III.B.2.

231. *Supra* Part III.A.

232. *See, e.g.*, Langbein & Posner, *supra* note 9, at 104–05 ("[T]rust law contains two doctrines, authorization and ratification, that permit the settlor and the beneficiary respectively to waive the ordinarily applicable law and thus to excuse the trustee from what would otherwise be a breach of trust.").

233. *See infra* Part IV.A.

234. *See infra* Part IV.B.

235. *See infra* Part IV.C.

236. *See supra* Part III.A.

into their contracts with clients to allow SRI. However, they cannot rely on ratification and should be wary of exculpation clauses due to the SEC's warning about such clauses.[237]

A. *Authorization*

It is the trust instrument itself that determines the trustee's duties and powers.[238] As long as the provision in the trust is explicit, it can permit trustees to engage in behavior that would otherwise violate their fiduciary duties.[239] An examination of cases demonstrates that SRI is among the behaviors that the trust instrument can authorize.[240] In *United Mine Workers of America v. Robinson*,[241] a collective-bargaining agreement increased benefits for widows whose husbands were receiving pensions when they died but not for widows whose husbands died before they retired.[242] The plaintiffs argued that the distinction between widows whose husbands were receiving pensions at death and those who were not had no rational relationship to the trust and was therefore illegal.[243] The trial court agreed, but the Supreme Court held that because the terms of the trust stated that the trustees must enforce benefit levels established in the collective bargaining agreement, whether or not such a distinction was reasonable was irrelevant.[244] In contrast, the court in *Rodriguez-Abreu v. Chase Manhattan Bank, N.A.*[245] held that since the terms of the pension plan did not specifically allow the administrator

237. *See infra* note 282 and accompanying text.

238. *See* RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007) ("The trustee has a duty to administer the trust . . . in accordance with the terms of the trust . . . ."); RESTATEMENT (SECOND) OF TRUSTS § 164(a) (1959).

239. *See supra* notes 117–127.

240. *See, e.g.*, Richardson, *supra* note 47, at 168 (stating that if a trust instrument "expressly requires the trustee" to implement SRI, then the trustee must do so).

241. 455 U.S. 562 (1982).

242. *Id.* at 564.

243. *Id.* at 568.

244. *Id.* at 573–74 (citing RESTATEMENT (SECOND) OF TRUSTS § 164). *See also id.* at 575 ("As long as such conditions do not violate federal law or policy, they are entitled to the same respect as any other provision in a collective-bargaining agreement.").

245. 986 F.2d 580, 584 (1st Cir. 1993).

discretion to review claims, such discretion did not exist.[246]

Case law thus shows that trust provisions are enforceable as long as they do not authorize otherwise illegal activity or behavior that violates public policy. This is the fundamental principle of authorization derived from case law, and this principle allows for SRI when SRI is not otherwise illegal—such as under ERISA[247]—or against public policy. Since fiduciary duties are contractual, investment advisers and broker-dealers who advise can use authorization in a similar manner. They need to ensure that clients who want their investments screened according to social criteria explicitly agree to this in their contracts. Advisers must fully disclose to their clients the risks of SRI.[248] Such disclosure is likely satisfied by a detailed description in the fund's prospectus or offering memorandum of how SRI applies to that fund and the risks it poses to the investor. Once disclosed, clients are free to impose whatever screening conditions they want on their investments as long as those conditions do not otherwise violate the law or public policy.

B. *Ratification*

Even if certain trustee behavior is not authorized, trustees are not legally liable for such behavior if the beneficiaries consented to it before or at the time it was done.[249] However, a beneficiary's mere failure to object is not consent;[250] beneficiaries

246. *See* Sinai Hosp. of Balt., Inc. v. Nat'l Benefit Fund for Hosp. & Health Care Emps., 697 F.2d 562, 567 (4th Cir. 1982) ("[C]ontracting parties . . . cannot control expenditures from funds already vested in a trust entity where the trust instrument reposes that authority solely with the trustees."); Thompson v. Trs. of Phillips Exeter Acad., 196 A.2d 42 (N.H. 1963) (stating that a trustee must administer a trust according to its terms and is not relieved of liability for failing to do so even if such failure resulted from a good-faith interpretation of those terms).

247. *See supra* Part III.C.

248. *See supra* note 156 and accompanying text. Included among such risks would be the possible harm to the fund resulting from SRI's mitigation of diversification or preclusion from investing in certain businesses. *See, e.g.*, *supra* Part II.

249. *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(3) (2007); RESTATEMENT (SECOND) OF TRUSTS § 216(1) (1959) ("[A] beneficiary cannot hold the trustee liable for an act or omission of the trustee as a breach of trust if the beneficiary prior to or at the time of the act or omission consented to it.").

250. *See* RESTATEMENT (SECOND) OF TRUSTS § 216 cmt. a (1959).

can retract consent before the deviant behavior;[251] and if there are several beneficiaries, all of them must consent before the trustee's liability is removed.[252] For such ratification to be valid, the ratifying beneficiaries should be aware of all material facts involved in the acts they ratify and of their rights in the matter, and must not be prevented from exercising those rights.[253] Advisers and broker-dealers cannot use ratification since there is no analogous doctrine in contract law.[254]

In *Marcucci v. Hardy*,[255] the plaintiff put his daughter's name on his bank account so she could control his money in his old age.[256] The plaintiff sued his daughter after she used this money to lend $150,000 to neighbors who were in serious financial difficulty,[257] arguing the loan violated the prudent-man standard.[258] But the court did not even consider whether the trustee violated this standard.[259] Rather, since the plaintiff had actively encouraged the loan[260] and knew that the neighbors were on the brink of losing their home,[261] the court found that the father had ratified his daughter's loan, and therefore, there was no breach of duty.[262]

United States v. Henshaw[263] is a case of a defendant's failed

251. *See id.* § 216 cmt. c.

252. *See id.* § 216 cmt. g.

253. *See e.g.*, *In re* Estate of Lange, 383 A.2d 1130, 1137-38 (N.J. 1978) (stating that a trust beneficiary may ratify a trustee's breach of duty and be precluded from suing if ratification was made with "full knowledge of all the material particulars and circumstances, and . . . [the beneficiary was] fully apprised of the effect of the acts ratified, and of his or her legal rights in the matter.").

254. *See* JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 5.14(a), at 209 (6th ed. 2009) (stating that parties must give consideration to modify an existing contract).

255. 65 F.3d 986 (1st Cir. 1995).

256. *Id.* at 988.

257. *Id.*

258. *Id.* at 992.

259. *Id.* ("We need not consider whether [defendant] violated the 'prudent man' standard, because . . . [plaintiff] actively encouraged the $150,000 loan to the [neighbors].")

260. *Id.* *See also id.* at 988 (stating that neighbors had cared for plaintiff for eighteen months while defendant was away on military duty, perhaps helping explain why plaintiff encouraged the loan).

261. *Id.* at 993.

262. *Id.*

263. 388 F.3d 738 (10th Cir. 2004).

attempt to use ratification as a defense. The defendant was an attorney representing a client in bankruptcy.[264] The client had established a debtor-in-possession account (DIPA), and the court ordered him to open a separate account to hold proceeds of sales of his property subject to federal-tax liens.[265] In violation of a court order, the client put funds from the property account into the DIPA.[266] Then, the defendant asked his client to pay his legal fees out of the DIPA even though the client could not withdraw from the fund without the court's approval.[267] The court ordered the defendant to pay back the money.[268] The defendant argued that the court's failure to respond to the bankrupt's earlier illegal transfers from the property account into the DIPA meant that the court ratified later violations.[269] However, the court said that ratification only applies when the beneficiary knows all material facts.[270] The court did not know all the material facts here because, for example, it did not know of the bankrupt's latest illegitimate transfers from which the defendant's fees were paid.[271]

Under ratification, trustees who engage in SRI could not be held liable for breaching their fiduciary duties if all the beneficiaries to the trust were aware of the SRI and consented to it. Consent cannot consist of a mere lack of objection, as in *Henshaw*, but rather there must be some affirmative manifestation of consent on the part of the beneficiaries, as in *Marcucci*. Unlike trustees, advisers and broker-dealers do not have the benefit of ratification. This is because advisers and broker-dealers operate under contracts rather than trust instruments, and contract law has no doctrine similar to ratification in trust law.[272] Rather, most jurisdictions apply the pre-existing duty rule to contract modification.[273] This rule

264. *Id.* at 740.
265. *Id.*
266. *Id.*
267. *Id.*
268. *Id.* at 741.
269. *Id.* ("[Defendant] . . . attempts to invoke the notion of ratification to undercut the Government's effort to reclaim its property.").
270. *Id.* at 742.
271. *Id.*
272. *See* PERILLO, *supra* note 254.
273. *See id.*

mandates that valid contracts cannot be modified without consideration.[274] Applying the rule to a contract between an adviser and client, if that contract does not allow the adviser to perform SRI, then the adviser simply cannot perform SRI unless the adviser and client amend the contract or make a new one. Therefore, advisers and broker-dealers should be sure to provide for SRI in their contracts before engaging in it. After all, if they cannot obtain permission for SRI in the contract, this means the client does not want SRI.

C. *Exculpation Clauses*

As the *Second Restatement* says, exculpation clauses cannot relieve trustees of their fiduciary duties if such clauses merely provide a general statement as to what the trustee is not liable for.[275] However, courts have enforced exculpation clauses that state exactly what type of otherwise duty-breaching behavior will not render a trustee liable. In *Perling v. Citizens & Southern National Bank*,[276] trust beneficiaries alleged that the trustees breached their duty of care by keeping in the trust stocks that fell drastically in value. The trustees argued that the trust had a clause allowing them to hold stock and relieving them of liability unless they acted in bad faith.[277] The court held that the provision did indeed absolve the trustees of liability for holding the stocks because it explicitly stated that it would.[278] In contrast, the court in *Jewett v. Capital National Bank*[279] held that there was a question of fact as to whether a clause relieving the trustee of liability for speculative investments also relieved the trustee from liability for doing nothing. The underlying principle governing whether or not courts uphold an exculpatory clause is that such a clause is valid as long as it is specific with

274. *See id.*

275. *See supra* notes 117–127 and accompanying text.

276. 300 S.E.2d 649, 674 (Ga. 1983).

277. *Id.* at 675. The clause stated "any investment retained by the Trustee in good faith shall be proper." *Id.*

278. *Id.* at 677 ("An examination of the cases . . . shows the result in a given case is controlled by the language of the instrument as construed under particular state laws and general trust principles."). Note, however, that this case was decided before the Georgia prudent-man statute was enacted.

279. 618 S.W.2d 109, 112 (Tex. App. 1981).

regard to the permitted behavior.[280] For example, an exculpation clause relieving a fiduciary from its general duty of care would not be valid. But a clause relieving a fiduciary from liability for loss resulting from SRI would be upheld because it unambiguously applies to specific behavior—engaging in SRI.

Practically speaking, exculpation clauses are little different from authorization.[281] Using either will relieve the fiduciary from liability for SRI as long as the trust instrument or contract leaves no room to doubt that SRI was contemplated by the settlor or agreed to by the client. However, advisers and broker-dealers who advise should consider the SEC's warning that exculpatory clauses may violate the anti-fraud provisions of the IAA if such provisions are likely to make clients believe they have waived rights of action against the adviser for gross negligence or willful misfeasance.[282] The bottom line is this: Fiduciaries should not perform SRI unless the source of their duties and obligations—be it a trust or contract—explicitly allows them to do so.

V. Conclusion

Socially responsible investing has existed for centuries, and its popularity has increased in the past few decades. The motivation of many who practice SRI has moved from striving to adhere to one's moral code to a grander notion of changing the behavior of others. While economics and statistics indicate that SRI has little influence over society at large, it remains valuable

280. *See, e.g.*, Hanson v. Minette, 461 N.W.2d 592, 597–98 (Iowa 1990) (holding exculpatory clause explicitly relieving trustee from liability for loss resulting for error of judgment valid to relieve trustee from liability for loss due to negligence); Neuhaus v. Richards, 846 S.W.2d 70, 75–76 (Tex. App. 1992) (holding exculpatory clauses may allow trustees to retain unproductive assets as long as such permission is explicit), *vacated*, 871 S.W.2d 182 (Tex. 1994); Westview Invs., Ltd. v. U.S. Bank Nat. Ass'n, 138 P.3d 638, 644 (Wash. Ct. App. 2006) (holding exculpatory clause explicitly precluding fiduciary and tort liability valid).

281. *See supra* Part IV.A.

282. *See* Letter from Kenneth C. Fang, Senior Counsel, SEC, to Heitman Capital Managerment, LLC (Feb. 12, 2007), *available at* http://www.sec.gov/divisions/investment/noaction/2007/heitman021207.pdf. To determine if an exculpatory clause violates the IAA, the SEC will account for "all of the surrounding facts and circumstances." *Id.* at 4.

for those who merely want to avoid funding or profiting from activities they consider immoral or socially harmful. Though fiduciary duties stand in the way of SRI by default, the doctrines of authorization and ratification, as well as exculpation clauses, can allow trustees to practice SRI. Moreover, the contractual nature of fiduciary duties makes authorization applicable to investment advisers and broker-dealers acting as advisers. Authorization allows SRI for trustees when the trust instrument explicitly permits it and for advisers when SRI is clearly provided for in their contract with the client. Ratification and exculpation clauses can relieve trustees from liability for SRI. Beneath all the history, law, and rhetoric lies one simple principle: Those entrusted with managing other people's money must remember whose money it is and act accordingly.