The Fiduciary Controversy: Injection of Fiduciary Principles into the Bank-Depositor and Bank-Borrower Relationships

Kenneth W. Curtis
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I. INTRODUCTION

Looking for a "deep pocket?" If so, you may be in luck. Courts today are holding a particular industry liable on a variety of tort theories and are awarding plaintiffs enormous verdicts, including large punitive damage awards. No, this industry has nothing to do with the manufacturing of dangerous products or toxic pollutants. It is the banking industry—an industry that throughout history has been considered a pillar of the community.

Today banks are more commercially oriented than ever before and soft-hearted juries have become more inclined to grant plaintiffs large damage awards. For instance, recently in Texas a borrower received a jury award of approximately $19 million against a group of lenders in an action based on fraud, duress and interference. In the Court of Appeals for the Fifth Circuit, the court recently reviewed a jury verdict in excess of $10 million against a bank on claims of misrepresentation and breach of fiduciary duty. California juries have been especially generous. The California Supreme Court recently affirmed a $1 million punitive damages verdict against a bank for fraudulent misrepresentation. Plaintiffs have discovered a desirable "deep pocket," and banks are justifiably concerned.

In the past, plaintiffs have asserted a wide variety of common-law theories of liability against banks including: fraud, misrepresentation, duress, excessive control, negligence, principal-agent, breach of contract, lack of good faith and an assortment of intentional torts. However, in recent litigation, the theory of tortious breach of fiduciary duty by the

2. In re Letterman Bros. Energy Sec. Litig., 799 F.2d 967 (5th Cir. 1986). In Letterman Bros., the bank moved for judgment notwithstanding the verdict. The district court granted the bank's motion on the fiduciary claim. The court of appeals affirmed the district court, holding that the financing bank owed no fiduciary duty to the investors. Id. at 975.
bank has been successfully asserted by plaintiffs. Unfortunately, courts have left banks with little guidance in trying to guess the basis for and boundaries of the judicial imposition of such “fiduciary” duties to their depositors and borrowers.

This Comment will focus on the recent and controversial injection of fiduciary principles into ordinary “bank-depositor” and “bank-borrower” relationships, and will expose the shaky ground upon which this application of fiduciary principles is founded. This Comment will not suggest that banks should never be regarded as fiduciaries to their customers since there are several instances in which they are. Rather, the author will explain fiduciary principles as they relate to banking, critically analyze two recent California appellate court cases which have misapplied such principles, and provide guidelines and suggestions that courts should consider when deciding whether fiduciary principles are present in a bank-depositor or bank-borrower relationship.

II. THE NATURE OF THE FIDUCIARY RELATIONSHIP

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilious of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

This quote from Chief Judge Cardozo describes the strict and ex-

4. In the bank-depositor relationship the depositor (customer) transfers its money to the bank. The bank becomes the debtor and the depositor is the creditor. The bank promises to pay out the depositor’s funds only at the request of the depositor.

5. In the bank-borrower relationship the bank transfers its money to the borrower (customer). The bank is now the creditor and the borrower is the debtor. The bank relies on the borrower’s promise to repay the funds entrusted to him.

6. See infra text accompanying notes 29-36.


tremely burdensome duties undertaken by one who assumes the role of a fiduciary. However, the term is not always applied with an understanding of the duties and responsibilities described by the Chief Judge. The concept of "fiduciary" is employed loosely by lawyers and courts in a variety of contexts.

A. Fiduciary Defined

Though the term "fiduciary" is often used, the available literature discussing this concept is relatively limited.9 "The term is derived from the Roman law, and means a person holding the character of a trustee . . . in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires."10 The dictionary definition of a fiduciary relationship illustrates its potentially broad interpretation and application. Black’s Law Dictionary defines a fiduciary relationship as being founded on trust or confidence reposed by one person "in the integrity and fidelity of another."11 A fiduciary relationship arises whenever confidence is reposed on one side, and domination and influence result on the other.12

The Restatement of Trusts states that a fiduciary "is under a duty to act for the benefit of the other as to matters within the scope of the relation."13 Similarly, the Restatement of Torts provides that “[a] fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation.”14

Another commentator offers the following synopsis of the history and principles of fiduciary obligations: “A fiduciary relationship exists

11. Id. at 564.
12. Id. A fiduciary “relationship exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other.” Id.
13. RESTATEMENT (SECOND) OF TRUSTS § 2 comment b (1959). The comment states that a fiduciary “is under a duty not to profit at the expense of the other and not to enter into competition with him without his consent . . . .” Id.
whenever any person acquires a power of any type on condition that he also receive with it a duty to utilize that power in the best interests of another, and the recipient of the power uses that power."15 Unfortunately, this summary provides no better guidance than the previous literature16 concerning which contracts or what aspects of those contracts ought to be governed by fiduciary principles.17 Despite the clear definitions of a fiduciary relationship, scholars and courts have not clearly established how this relationship arises in any given context.

B. The Courts’ Interpretation of Fiduciary

In 1983, the California Supreme Court helped clarify these various definitions by holding that "[a] fiduciary . . . assumes duties beyond those of mere fairness and honesty . . . [and] must undertake to act on behalf of the beneficiary, giving priority to the best interest of the beneficiary."18 However, the court proceeded with caution in deciding when fiduciary obligations actually arose. It held that "before a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law."19

For the most part, California courts are reluctant to find fiduciary relationships in commercial contexts. Courts will impose a fiduciary duty only where the circumstances provide for an exception to the ordinary expectation that each party to a commercial transaction will look after his own interests.20 Mere “friendship or confidence in the professional skill and in the integrity and truthfulness of another” does not

15. J. SHEPHERD, supra note 9, at 96.
17. Jacobson, supra note 9, at 528 n.40.
18. Committee on Children’s Television, Inc. v. General Foods Corp., 35 Cal. 3d 197, 222, 673 P.2d 660, 676, 197 Cal. Rptr. 783, 799 (1983). In Children’s Television, the plaintiff alleged that General Foods owed a fiduciary obligation to child consumers, and breached that duty through deceptive and misleading advertising in its marketing of sugared cereals. Id. at 204, 673 P.2d at 663-64, 197 Cal. Rptr. at 786-87. The plaintiff also argued that imposition of fiduciary obligations is appropriate whenever one party has a superior bargaining position or greater knowledge of the facts. Id. at 221, 673 P.2d at 675, 197 Cal. Rptr. at 798. However, the court held, “the efforts of commercial sellers—even those with superior bargaining power—to profit from the trust of consumers is not enough to create a fiduciary duty. If it were, the law of fiduciary relations would largely displace both the tort of fraud and much of the Commercial Code.” Id.
19. Id., 673 P.2d at 675-76, 197 Cal. Rptr. at 799; see Scott, supra note 9, at 540; RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).
trigger such an exception.21 Even close friends, when entering a business transaction, exercise independent business judgment and act autonomously. The law will not impose a fiduciary duty on one party to act in the other’s best interests.22 The circumstances must show that the confidence reposed and accepted decreases one party’s ability or willingness to act in its own self-interest.23

An analysis of the case law suggests that, in the bank-customer relationship, courts will find that a fiduciary relationship exists when two elements are present: (1) the customer has reposed trust and confidence in the bank; and (2) the bank has invited or accepted such trust and confidence. However, this Comment suggests that fiduciary principles should not be applied to ordinary commercial transactions. Imposition of fiduciary obligations in bank-depositor or bank-borrower relationships creates a serious conflict of interest for the bank. Banks are private commercial enterprises, engaged in financial activity for the purpose of making money. If a bank is labeled a fiduciary, its power to transact business with its customer is severely limited. The California Supreme Court held that a fiduciary "must use the utmost good faith and, if he profits from the transaction, the law presumes the agreement was entered into by the beneficiary ‘without sufficient consideration and under undue influence.’ "24

Based on this holding, a profit minded institution such as a bank could not protect its own best interests while under a fiduciary duty to act for the benefit of the customer—giving priority to the customer’s best interests.25 If courts intend to introduce fiduciary principles into a bank-customer relationship, "they will need to decide whether its importation into the banker and customer context is really appropriate, clarify the meaning of fiduciary and distinguish it from other similar legal principles."26

22. See Kudokas v. Balkus, 26 Cal. App. 3d 744, 750-51, 103 Cal. Rptr. 318, 321-22 (1972) (no confidential relationship found between two parties to a real estate transaction who were long-term friends because buyers, although naive, exercised independent judgment); see also infra notes 164-66 and accompanying text.
24. Children’s Television, 35 Cal. 3d at 222, 673 P.2d at 676, 197 Cal. Rptr. at 799 (citation omitted) (quoting Cal. Civ. Code § 2235 (West 1983)).
25. See supra text accompanying notes 195-200.
III. THE BANK AS A FIDUCIARY

It has generally been held that "[t]he relationship of debtor and creditor without more is not a fiduciary relationship. A fiduciary relationship may be created . . . only when both parties understand that a special trust or confidence has been reposed."27 The mere rendering of advice and counseling by a lending institution to a customer is not sufficient by itself to create a fiduciary relationship.28

A. Situations Where Banks are Accepted as Fiduciaries

Banks have invited and accepted the title of fiduciary in certain contexts. For example, banks often establish trust departments that are governed by statutory and common law fiduciary principles.29 The bank, as a trustee, must abide by the law of trusts—acting solely in the interests of the customer or beneficiary.30

In addition, banks have been regarded as fiduciaries in certain "control creditor" cases. As a lender, the bank may become a control creditor by becoming so involved in the borrower’s daily operations that the bank has, in effect, dominated the borrower to the extent that the borrower has lost its separate identity.31 In Taylor v. Standard Gas & Electric Co., the United States Supreme Court held that a lender who assumes a "controlling" position vis-a-vis its borrower may occupy a fiduciary position to both the borrower and the borrower’s other creditors.32 In this situation, “a non-insider creditor [bank] will be held to a fiduciary standard only where his ability to command the debtor's obedience to his policy directives is so overwhelming that there has been, to some extent, a merger of identity.”33 Before imposing fiduciary duties

28. Umbaugh, 58 Ohio St. 2d at 286, 390 N.E.2d at 323; see also Stenberg v. Northwestern Nat'l Bank, 307 Minn. 487, 238 N.W.2d 218 (1976). For a discussion of Stenberg, see infra text accompanying notes 71-73.
29. See Magruder v. Drury, 235 U.S. 106 (1914) (common-law duty for fiduciary to act "solely" in the interest of the beneficiary); RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959) ("The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary.").
upon a bank in a control creditor situation, the court will generally require that the bank is, "in effect, the alter ego of the debtor."\(^{34}\)

In a commercial loan,

banks must recognize that once it is established that they are in control of a borrower's business, whether through the exercise of rights granted in the loan, . . . through exercise of voting control, . . . through participation on the borrower's board of directors, or otherwise, they might have a fiduciary responsibility to the borrower's shareholders and can be held responsible for any resulting mismanagement of the company.\(^{35}\)

In determining whether a creditor has gained control of a debtor, courts consider several factors, including: financial dependence; restrictive covenants within the agreement; control over disbursements; and other restrictions indicative of control.\(^{36}\)

When the bank acts as a trustee, or assumes a control creditor position with regard to the borrower, the borrower is entirely dependent on the bank and the bank undertakes to advise, counsel and protect the borrower. In the trustee and control creditor relationships, the courts are willing to impose, and banks are willing to accept, the role of a fiduciary and the special burdens and obligations that accompany that role. However, this gross imbalance of power and expectation of fiduciary obligations present in the trustee and control creditor relationships is non-existent in ordinary bank-depositor and bank-borrower relationships and therefore courts should not impose fiduciary obligations upon banks in such contexts.

**B. The Bank-Depositor Relationship**

In the ordinary bank-depositor relationship, where the depositor places his money in the bank in return for the bank's promise to pay out the money at his request, the bank is the debtor and the depositor is the creditor. "This is the 'standard' deposit contract presumed by the Uniform Commercial Code."\(^{37}\) The customer perceives the bank as a

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34. Id.


“bailee” of the deposited funds.

In 1906, the California Supreme Court established that the relationship between bank and depositor is merely that of debtor and creditor. The court held that “the customer can never hold or charge the bank as a trustee, quasi-trustee, factor, or agent.” Courts in California and those in other jurisdictions employ similar reasoning by holding that the relationship of a bank to its depositors is that of debtor and creditor, and is not a fiduciary relationship. For example, the court in Morse v. Crocker National Bank held that a deposit, in effect, is a loan to the bank—the bank is obligated to pay the debt. Although the bank holds the depositor’s money, the court stated that it does not act as a trustee or incur the fiduciary obligations of a trustee. The United States Supreme Court also adopted this rule, concluding that the “relationship of bank and depositor is that of debtor and creditor, founded upon contract.”

Inherent in a contractual relationship is the assumption that each party to the contract will protect its own interests. Accordingly, this inherent assumption must also apply in the “contractual” bank-depositor relationship. Because there is no reposing of trust and confidence in the bank by the depositor nor an invitation or acceptance of such by the

38. Black’s Law Dictionary defines bailee as “one to whom goods are bailed; the party to whom personal property is delivered. A species of agent to whom something movable is committed in trust for another.” BLACK’S LAW DICTIONARY 128 (5th ed. 1979).

39. Smiths’ Cash Store v. First Natl Bank, 149 Cal. 32, 84 P. 663 (1906) (action by depositor against bank for damages to its credit resulting from bank’s refusal to pay checks drawn upon it by depositor).

40. Id. at 34-35, 84 P. at 664; see also State ex rel. Rankin v. Banking Corp., 77 Mont. 134, 251 P. 151 (1926).


42. 142 Cal. App. 3d 228, 190 Cal. Rptr. 839 (1983).

43. Id. at 232, 190 Cal. Rptr. at 842.


bank, there is no basis to impose fiduciary obligations upon the bank.\(^{46}\)

## C. The Bank-Borrower Relationship

In the bank-borrower relationship the roles of debtor and creditor are reversed; the bank lends its money in return for the borrower's promise to repay.\(^{47}\) The bank is now the creditor and the borrower the debtor. Like the bank-depositor relationship, it is an established principle that the relationship between the bank and its borrower is that of debtor and creditor and does not give rise to fiduciary responsibilities.\(^{48}\) Unfortunately, recent cases have muddled these distinctions leaving the status of the bank in a bank-borrower relationship unclear and creating conflicts among jurisdictions.

The most often cited, and perhaps the most important decision concerning this issue is the Minnesota Supreme Court's decision in *Klein v. First Edina National Bank*.\(^{49}\) In *Klein*, the plaintiff sued when her bank foreclosed on stock she pledged as collateral for a loan the bank granted to her employer. Unaware that her employer already owed the bank $9,250 and that the bank intended to rely entirely on the plaintiff's stock as security for both loans, the plaintiff alleged fraud based on the bank's failure to inform her of all the details of the transactions.\(^{50}\) Although a bank is generally under no fiduciary duty to the borrower, the *Klein* court held that special circumstances may exist requiring the bank to disclose certain material facts:

> We believe the correct rule to be that when a bank transacts business with a depositor or other customer, it has no special duty to counsel the customer and inform him of every material fact relating to the transaction . . . unless special circumstances exist, such as where the bank knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank so to counsel and inform him.\(^{51}\)

The *Klein* court found that the "special circumstances" required for

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46. See *supra* text accompanying notes 10-26 for a discussion of the "fiduciary" concept.
47. T. Eisenberg, *supra* note 37, at 12A-4.
49. 293 Minn. 418, 196 N.W.2d 619 (1972).
50. *Id.* at 421, 196 N.W.2d at 621-22.
51. *Id.* at 422, 196 N.W.2d at 623.
imposing a special duty on the bank were absent in the case before it. The plaintiff had been a customer of the bank for nearly twenty years, and she testified that she trusted the bank's representatives just as she would a doctor or a lawyer. The court nevertheless found no evidence in the record to indicate that the bank knew or should have known that the plaintiff was placing her trust and confidence in the bank.

1. Cases cited to support a fiduciary relationship

Various courts cite cases similar to *Klein* to support a finding of breach of fiduciary duty on the part of a bank. However, most of these cases focused on fraud or a duty to disclose rather than breach of fiduciary duty. For example, in *First National Bank in Lennox v. Brown*, the Supreme Court of Iowa held that a party in a position of trust, who has superior knowledge of the facts, has a duty to disclose all material facts of which he is aware, or at least those favorable to his position and adverse to the other. In *Brown*, the bank negotiated a purchase money loan with Brown but failed to reveal that a major portion of the loan would be used to erase the bank's lien on the property being transferred. The court stated that bank-borrower loan agreements are not arm's-length transactions; rather "there exists a relationship of trust or confidence" and the bank "has superior knowledge of the facts." Unlike *Klein*, the *Brown* court held that there was imposed upon the bank an "unfulfilled duty of disclosure"—because the bank had far more familiarity with the operative facts of the transaction than did Brown. The *Brown* court, however, failed to support its conclusion that a relationship of trust and confidence existed between the bank and its borrower. The court made no reference to a reposing of trust and confidence upon the bank, nor to the bank's acceptance or knowledge of such trust and confidence.

In *Stewart v. Phoenix National Bank* the Arizona Supreme Court became one of the first courts to determine that "the relation between plaintiff [customer] and defendant [bank] was far beyond that of a mere

52. *Id.* There was "no evidence in the record to indicate that defendant ought to have known that plaintiff was placing her trust and confidence in defendant and was depending upon defendant to look out for her interests." *Id.*
53. *Id.*
54. 181 N.W.2d 178 (Iowa 1970).
55. *Id.* at 182.
56. *Id.*
57. *Id.*
58. 49 Ariz. 34, 64 P.2d 101 (1937).
debtor and creditor."  

In *Stewart*, the plaintiff was a customer of the bank for about twenty-three years and relied on the directors and officers of the bank for financial advice. Previously, plaintiff had borrowed large sums of money from the bank, giving no security. By 1931, the plaintiff owed the bank $17,800. In order to secure the notes, the bank requested from plaintiff a mortgage on real estate he owned as security for the debt. The plaintiff alleged that the bank requested the mortgage with the "intent to deceive and defraud plaintiff out of his property." Additionally, the plaintiff claimed that the bank officers, knowing that he would rely upon their representations, "wilfully and wickedly and falsely represented to the plaintiff that it did not want his property." In holding for the plaintiff, the court noted that in 1937 changes were under way in the banking industry:

Banks . . . were originally merely places of security where a man might deposit his cash and valuables . . . . But times have changed. . . . [I]n many, if not most, cases an investor will consult his bank . . . believing that he has the right to rely upon the advice of its officers as being given in good faith.

*Stewart* represented the beginning of a movement away from the general rule of the bank-borrower relationship as a debtor-creditor relationship. It was the first in a number of cases recognizing the change in consumer attitudes towards the banking industry. However, it appears to be a minority position; the general rule still characterizes the bank-borrower relationship as that of debtor-creditor.

Under Montana law, it is an established principle that the relationship between a bank and its customer is that of debtor and creditor and does not give rise to fiduciary responsibilities. Nevertheless, in *Deist v. Wachholz*, the Montana Supreme Court recognized an exception to this principle. The court held that "modern banking practices involve a highly complicated structure of credit and other complexities which often thrust a bank into the role of an advisor, thereby creating a relationship of trust and confidence which may result in a fiduciary duty upon the bank . . . ." Whether a bank owes fiduciary duties to a loan

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59. *Id.* at 44, 64 P.2d at 106.
60. *Id.* at 40, 64 P.2d at 104.
61. *Id.* at 41, 64 P.2d at 104.
62. *Id.* at 45, 64 P.2d at 106.
63. See, e.g., *Rankin*, 77 Mont. 134, 251 P. 151.
64. 678 P.2d 188 (Mont. 1984).
customer depends upon "proof of a special relationship."\(^{66}\)

In Deist, the plaintiff associated with the same bank for about twenty-four years. During that time, the bank acted as the plaintiff's financial advisor, causing the plaintiff to rely upon its counsel. The dispute arose when the plaintiff's husband died leaving her with a $200,000 debt from a ranch they owned. The president of the bank, a family friend, advised the plaintiff to sell the property. Defendant Wachholz, a vice president of the bank, had the duty of finding a buyer. Wachholz found a buyer who negotiated a purchase with the plaintiff. A few days later the plaintiff learned that Wachholz was in partnership with the buyer. The contract, however, failed to indicate that Wachholz or any other buyers were involved. The plaintiff's complaint sought rescission of the contract and damages against the bank and Wachholz based on an alleged breach of a fiduciary duty.\(^{67}\) The court held that the bank was bound to insure that the plaintiff was not "'insufficiently informed of some factor which could affect [plaintiff's] judgment.'"\(^{68}\) While not dismissing the general notion that the bank-depositor relationship is that of debtor-creditor, the court determined there were exceptions in certain situations.\(^{69}\) The court concluded that by failing to inform the plaintiff of Wachholz' involvement with the purchaser, the bank breached its fiduciary duty to the plaintiff.\(^{70}\)

Courts finding a fiduciary relationship to exist between a bank and its borrowers base their holding on an assumption of a "special relationship." Unfortunately, these courts often assumed a special relationship existed, rather than requiring proof of its existence.

2. Cases holding "no fiduciary relationship"

Several jurisdictions have adopted the Klein holding that a bank will

\(^{66}\) Id.

\(^{67}\) Id. at 192.

\(^{68}\) Id. at 195 (quoting Lloyds Bank, Ltd. v. Bundy, 3 All E.R. 757 (C.A. 1974)). The bank in Deist had an obligation to inform plaintiff fully and to do nothing that would place the plaintiff at a disadvantage. Id.

\(^{69}\) Id. at 193. The court suggested that:

[One] who speaks must say enough to prevent his words from misleading the other party; one who has special knowledge of material facts to which the other party does not have access may have a duty to disclose these facts to the other party; and one who stands in a confidential or fiduciary relation to the other party... must disclose other facts.

Id. (emphasis added) (quoting Tokarz v. Frontier Fed. Sav. & Loan Ass'n, 33 Wash. App. 456, 656 P.2d 1089 (1983)).

\(^{70}\) Id. at 194. The court found that because the bank acted as the plaintiff's financial advisor, and the plaintiff undoubtedly relied upon their counsel, the officers of the bank owed to plaintiff a fiduciary duty—and that fiduciary duty extended to Wachholz. Id.
generally have no special duty to counsel and inform the customer unless
the bank knows or has reason to know that the customer is justifiably
placing trust and confidence in the bank. For instance, in *Stenberg v.
Northwestern National Bank of Rochester*,71 the Minnesota Supreme
Court rejected the plaintiffs’ claim that they “relied” upon the bank’s
advice in a loan arrangement. The Stenbergs, owners of a small wood
products company, wished to expand their business. To finance this ex-
pansion, the Stenbergs opened a line of credit with the bank. When their
indebtedness increased, the bank encouraged them to seek a loan from
the Small Business Administration of the federal government in order to
consolidate and reduce their debt to the bank. A bank officer assured the
Stenbergs that their relationship with the bank would help their business
grow and that they should not worry about their increasing indebtedness.
Claiming they relied upon the bank’s advice, the Stenbergs sued the
bank, in a fiduciary capacity, for misrepresentations made to them.

The court rejected the Stenbergs’ assertion, holding that the evi-
dence would not support a “basis for plaintiffs’ claim that a fiduciary
relationship existed between plaintiffs and defendants.”72 The court de-
determined that Mr. Stenberg was a businessman, “capable of independent
judgment” and concluded that no basis existed for an exception to the
general rule that a bank owes no special duty to its
borrowers.73

In *Denison State Bank v. Madeira*,74 the Supreme Court of Kansas
described a fiduciary relationship as follows:

A fiduciary relationship imparts a position of peculiar con-
fidence placed by one individual in another. A fiduciary is a
person with a duty to act primarily for the benefit of another.
A fiduciary is in a position to have and exercise, and does have
and exercise influence over another. A fiduciary relationship
implies a condition of superiority of one of the parties over the
other. Generally, in a fiduciary relationship, the property, inter-
est or authority of the other is placed in the charge of the
fiduciary.75

71. 307 Minn. 487, 238 N.W.2d 218 (1976).
72. Id. at 488, 238 N.W.2d at 219.
73. Id.; see MacKenzie v. Summit Nat’l Bank, 363 N.W.2d 116 (Minn. App. 1985); see
infra note 180 for a discussion of MacKenzie.
75. Id. at 692, 640 P.2d at 1241 (citing 36A C.J.S. Fiduciary (1961)). The court in Denison
cited an early appellate court case to show some definitive elements that are relevant in deter-
mining whether a fiduciary relationship exists: “There is no invariable rule which determines
the existence of a fiduciary relationship, but it is manifest in all the decisions that there must be
not only confidence of the one in the other, but there must exist a certain inequality . . . giving
Denison involved a bank suing to recover the balance due on three promissory notes executed by the defendant and guaranteed by his wife. The defendant counterclaimed for damages alleging that the bank fraudulently obtained the notes while under a fiduciary duty to the defendant. The defendant alleged that the bank made false representations of fact regarding the loans and that the bank intentionally failed to disclose its knowledge of key financial statements and the status of its loan to a pertinent party.\footnote{Previously, in \textit{Dugan v. First National Bank},\textsuperscript{77} the Kansas Supreme Court had established that “Kansas recognizes the general rule that the relationship between a bank and its depositor is that of creditor-debtor and not of a fiduciary.”\textsuperscript{78} The \textit{Denison} court held that the facts “[did] not take it out of the general rule and are insufficient to support a finding of a fiduciary relationship.”\textsuperscript{79} The court reasoned that “one may not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on another without a conscious assumption of such duties by the one sought to be held as a fiduciary.”\textsuperscript{80} The court determined that the defendant could not avoid responsibility for exercising diligence for his own protection by simply relying on the bank to provide him with information he never requested. Like the court in \textit{Stenberg}, the \textit{Denison} court held that the defendant was “fully competent and able to protect his own interests.”\textsuperscript{81} In a more recent case, \textit{Kurth v. Van Horn},\textsuperscript{82} the Supreme Court of Iowa also observed the general rule that “a fiduciary duty or confidential relationship does not arise solely from a bank-depositor relationship.”\textsuperscript{83} The plaintiff in \textit{Kurth} argued that the rule should be different when a customer becomes a borrower. However, the court determined that, in

to one advantage over the other.” \textit{Id.} (quoting \textit{Yuster v. Keefe}, 46 Ind. App. 460, 466, 90 N.E. 920, 922 (1910)).  
\textsuperscript{76} \textit{Id.} at 687, 640 P.2d at 1238. The pertinent party was the owner of a General Motors dealership which the defendant was seeking to buy into. The owner did business at Denison State Bank, was heavily indebted to the bank, and the officers of the bank were aware of his financial difficulties. Defendant contended that the bank breached its fiduciary duty by failing to make full disclosure of the dealership owner's financial involvement with the bank. \textit{Id.} at 686-87, 640 P.2d at 1237-38.  
\textsuperscript{77} 227 Kan. 201, 606 P.2d 1009 (1980).  
\textsuperscript{78} \textit{Id.} at 207, 606 P.2d at 1014.  
\textsuperscript{79} \textit{Denison}, 230 Kan. at 695, 640 P.2d at 1243.  
\textsuperscript{80} \textit{Id.} at 696, 640 P.2d at 1243-44.  
\textsuperscript{81} \textit{Id.}, 640 P.2d at 1244. The defendant could have acquired the allegedly concealed facts through reasonable effort. This view is consistent with finding parties to a contract able to defend themselves. \textit{See infra} text accompanying notes 185-91.  
\textsuperscript{82} 380 N.W.2d 693 (Iowa 1986).  
\textsuperscript{83} \textit{Id.} at 696.
such situations, there was no fiduciary relationship between the bank and its customer. In *Kurth*, Mr. Gerdes (deceased) co-signed a note in connection with a bank loan to Mr. Hall (a farmer who asked Gerdes to help him get a loan). The loan was secured by a mortgage on farmland owned by Gerdes. Plaintiff, the trustee of Gerdes' estate, sued the bank alleging fraud and breach of fiduciary duty. Plaintiff claimed that a fiduciary relationship existed between the bank and Gerdes because Gerdes was eighty years old, was under pressure by Hall to secure the loan, made several visits with Hall to the bank, and was not advised of Hall's financial problems of which the bank had knowledge.

Considering Hall's financial background, Gerdes was clearly ill-advised to co-sign the loan. The court, however, rejected the plaintiff's suggestion that the bank should have refused to conclude the loan until Gerdes secured legal counsel. "[T]his form of protectionism goes far beyond the exercise of the banker's responsibility... and its failure to do so does not amount to a breach of fiduciary duty. The bank had no affirmative duty to prevent Gerdes from doing what the evidence clearly shows he wanted to do." 84 In the wake of *Klein*, the *Kurth* court held that although there was an alleged reposing of trust and confidence by the customer, there was no substantial evidence to show that the customer relied on the bank's advice, or that if he did rely, the bank was aware of such reliance. 85

Most jurisdictions have accepted the general proposal of *Klein* and similar cases that a bank generally has no fiduciary duty to a borrower unless there is confidence justifiably reposed by the customer and the bank invites, accepts, knows or has reason to know that the customer is placing his trust and confidence in it. 86 However, recent California decisions have cast aside this rule and held banks to fiduciary standards where a careful analysis would reveal that the imposition of fiduciary duties was completely unwarranted. This Comment will now examine several cases in an effort to illustrate how these courts have strayed from established fiduciary principles concerning bank-depositor and bank-borrower relationships.

84. Id. at 697.
85. Id. at 698.
86. It should be noted that although *Klein* set up the special rule for finding a fiduciary duty, it held:
The fact that plaintiff had done business with defendant for nearly 20 years could not by itself place defendant in a confidential relation to plaintiff. Nor could the fact that plaintiff had occasionally socialized with the wife of defendant's president somehow change the character of defendant's relation to plaintiff into a fiduciary one.

*Klein*, 293 Minn. at 422, 196 N.W.2d at 623.
IV. CALIFORNIA'S RECENT APPLICATION OF FIDUCIARY PRINCIPLES TO BANK-CUSTOMER RELATIONSHIPS

The previous discussion of case law reveals that the concept of fiduciary obligation in the bank-customer relationship is at best confusing. Although several state supreme courts have addressed this issue, none has provided adequate guidelines or standards establishing when a fiduciary relationship arises. Recently, one California appellate court has rendered controversial decisions in both the bank-depositor and bank-borrower contexts. This Comment will show that these cases are not sound decisions in establishing that the ordinary bank-depositor or bank-borrower relationship gives rise to fiduciary responsibilities.

A. Commercial Cotton Co. v. United California Bank—The Bank-Depositor Relationship

1. Facts and application of law

In *Commercial Cotton Co. v. United California Bank,* 87 a California court held that the relationship between a bank and its depositor is at least "quasi-fiduciary." 88 The court reached this conclusion by finding that banking is a highly regulated industry performing a vital public service and that the depositor is totally dependent on the bank's honesty to protect the deposited funds. 89

In *Commercial Cotton,* the plaintiff, a customer of United California Bank (UCB), advised UCB that it had lost some of its checks. However, the plaintiff failed to place stop orders on these missing checks or close the account. Four years later, one of the missing checks, bearing unauthorized signatures, was deposited with another bank and processed by UCB. Eighteen months later, Commercial Cotton discovered that the check had been negotiated and demanded its account be re-credited. UCB declined, citing as a defense the one-year limitation on bringing such claims. 90 Commercial Cotton brought a tort action against UCB claiming that UCB breached its "implied covenant of good faith and fair

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88. Id. at 516, 209 Cal. Rptr. at 554.
89. Id.
90. CAL. COM. CODE § 4406 (West 1964). Section 4406 provides that:

Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subdivision (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or any unauthorized indorsement . . . is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

*Id.*
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dealing" by asserting spurious defenses to avoid liability.

The Commercial Cotton court held that UCB should have been


California courts have recognized the existence of this covenant in a wide variety of contract cases. In insurance and employment cases, the California Supreme Court has held that a breach of the implied covenant of good faith and fair dealing may give rise to a cause of action in tort as well as in contract. See, e.g., Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980) (court intimated that breach of covenant of good faith and fair dealing in the employment relationship might give rise to tort remedies—comparing the relationship with the insured-insurer relationship); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967) (breach of implied covenant of good faith and fair dealing could give rise to damages in tort); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958) (insurer who wrongfully declines to defend and refuses to accept a reasonable settlement within policy limits violates the implied covenant of good faith and fair dealing and is liable for entire judgment, even if it exceeds the policy limits); Hannon Eng'g, Inc. v. Reim, 126 Cal. App. 3d 415, 179 Cal. Rptr. 72 (1981) (unwarranted delay by an employer in honoring employees' request for payment of pension is a tortious breach of the implied covenant of good faith and fair dealing, emphasizing the adhesive nature of the employment contract); Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) (employer's discharge of a senior employee for union activities may result in tort liability for breach of the implied covenant of good faith and fair dealing); Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970) (disability insurer's bad faith refusal to make payment under policy constituted breach of implied covenant entitling insured to contract damages, emotional distress damages and, in appropriate cases, punitive damages); see also Hudson v. Moore Business Forms, Inc., 609 F. Supp. 467 (N.D. Cal. 1985); Inforex Corp. v. MGM/UA Entertainment Co., 608 F. Supp. 129 (C.D. Cal. 1984).

92. In Seaman's, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354, the California Supreme Court held that a contracting party seeking to avoid liability by adopting a "stone-wall" position without probable cause and with no belief in the existence of a defense may be sued in tort because it has done more than merely breach the contract. Id. at 769-70, 686 P.2d at 1167, 206 Cal. Rptr. at 363. "Acceptance of tort remedies in such a situation is not likely to intrude upon the bargaining relationship or upset reasonable expections [sic] of the contracting parties." Id. at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

In Seaman's, a dispute arose out of a contractual agreement between a ship supply dealer and an oil supplier. The parties made a dealership agreement under which the supplier was to supply the ship dealer's fuel requirements. The oil dealer subsequently denied the existence of the contract. The court held that "a party to a contract may incur tort remedies when, in addition to breaching the contract, it seeks to shield itself from liability by denying, in bad
aware of a recent California Supreme Court case\(^9\) in which the court determined that the one-year statutory limitations relied upon by the bank does not apply when a customer sues a bank for negligent conduct.\(^{95}\) The court relied on *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*\(^9\) which found that tortious breach of the implied covenant of good faith and fair dealing arises if (1) a special relationship exists between the parties (i.e., insured-insurer relationship), or (2) one party denies, in bad faith, the existence of the contract. The *Commercial Cotton* court upheld the trial court's finding that UCB breached its implied covenant of good faith and fair dealing. The court stated, "UCB's claimed defenses are spurious, . . . legal counsel interposing them in an unjustifiable, stonewalling effort to prevent an innocent depositor from recovering money entrusted to and lost through the bank's own negligence."\(^97\) Accordingly, the court found UCB liable in tort because the evidence overwhelmingly supported a finding that UCB breached the covenant of good faith and fair dealing with the plaintiff.\(^98\)

Unfortunately, the *Commercial Cotton* court did not base its holding on the bad faith denial rationale. Instead, the court introduced "fiduciary principles" into its rationale for establishing tortious breach of the

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93. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354. See supra note 92 and accompanying text for a discussion of *Seaman's*.
94. Id. at 516, 209 Cal. Rptr. at 554.
95. Id. at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.
96. Id. at 699, 582 P.2d at 940, 148 Cal. Rptr. at 348. The court therefore applied the three-year statute of limitations of California Civil Code § 338(3) for negligent injury to property. Id. at 700, 582 P.2d at 940, 148 Cal. Rptr. at 349.
97. Id. at 700, 582 P.2d at 940, 148 Cal. Rptr. at 349.
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The court held, "[t]he relationship of bank to depositor is at least quasi-fiduciary, and depositors reasonably expect a bank not to claim nonexistent legal defenses to avoid reimbursement when the bank negligently disburses the entrusted funds." 99

By finding tort liability based on a special relationship between the parties, this unparalleled holding established that any breach of the implied covenant of good faith and fair dealing by a bank exposed it not only to contractual remedies, but also to the full range of tort remedies, including punitive damages. To support its holding for such a tort action based on fiduciary principles, the court in *Commercial Cotton* cited the only line of cases which have authorized such a claim for damages in a contractual setting—insurance cases. 100 In the context of insurance contracts, the California Supreme Court has emphasized that the relationship between the insurer and the insured is characterized by elements of public interest, adhesion and fiduciary responsibility. 101

In *Egan v. Mutual of Omaha Insurance Co.*, 102 the California Supreme Court set forth the factors which establish a "special relationship" necessary before a breach of the covenant of good faith and fair dealing can be alleged as a tort. Analogizing to those factors, the *Commercial Cotton* court held that "banking and insurance have much in common, both being highly regulated industries performing vital public services substantially affecting the public welfare." 103 As a result of this reasoning, the court in *Commercial Cotton* became the first court to hold that the relationship between a bank and its depositor is at least "quasi-fiduciary." 104 By introducing fiduciary principles into the bank-depositor relationship, the *Commercial Cotton* court may have opened the pro-

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99. Id.

100. See, e.g., Crisci, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (breach of implied covenant of good faith and fair dealing could give rise to damages in tort); *Comunale*, 50 Cal. 2d 654, 328 P.2d 198 (insurer who wrongfully declines to defend and who refuses to accept a reasonable settlement within the policy limits violates the implied covenant of good faith and fair dealing and is liable for the entire judgment, even if it exceeds the policy limits); *Fletcher*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (disability insurer's bad faith refusal to make payment under a policy constituted breach of implied covenant entitling insured to contract damages, emotional distress damages and, in appropriate cases, punitive damages).

101. See *Egan*, 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482. The court in *Egan* set out the factors which create the necessary "special relationship" to establish a claim for breach of the implied covenant of good faith and fair dealing. *Id.* at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.

102. 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482.


104. *Id.*
verbial "floodgates" for tort liability against the banking industry where it did not exist in the traditional debtor-creditor relationship.

2. Critique of Commercial Cotton

In Commercial Cotton, the court introduced the notion that the relationship between a bank and its depositor is at least "quasi-fiduciary" because banking is a highly regulated industry, affected with the public interest, performing a vital public service and the depositor is totally dependent on the bank's "honesty and expertise" to protect the deposited funds. However, Commercial Cotton violates established precedent, including California Supreme Court decisions, which have held that the relationship between a bank and its depositor is that of debtor-creditor and not a fiduciary. The court's decision in Commercial Cotton is both unparalleled and unsupported.

a. insurance vs. deposit contracts

To hold that the bank tortiously breached the covenant of good faith and fair dealing, the court in Commercial Cotton had to establish that the requisite "special relationship" existed between the bank and the depositor. The court's holding that the bank is a "quasi-fiduciary" is entirely inconsistent with previous decisions. This fiduciary duty has never been endorsed by the California Supreme Court except in circumstances inherent in insurance and employment contracts.

The insurance cases emphasize that:

(a) the purpose of an insurance policy is not to obtain a "commercial advantage" but to secure both protection against calamity and peace of mind, (b) insurers serve a quasi-public function which requires them to consider the public interest in addition to the profit motive, (c) insurers enjoy a superior bargaining position over their insureds, and (d) the relationship between the insurer and the insured is quasi-fiduciary.

In Seaman's, the California Supreme Court cautioned that extension of

105. Id.
106. See supra text accompanying notes 37-46.
107. In Egan, the California Supreme Court described the "special relationship" that exists between the insurer and the insured. The court noted that insurers' obligations are quasi-public in nature and that "the relationship of insurer and insured is inherently unbalanced; the adhesive nature of insurance contracts places the insurer in a superior bargaining position." Egan, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.
108. See supra text accompanying notes 37-46.
109. See supra notes 91 & 100 for cases discussing insurance and employment contracts.
110. Burke, Thomas & Warren, Emerging Theories of Bank Liability, in PRACTISING LAW
such duties and ensuing tort damages into the commercial contract realm would lead "into largely uncharted and potentially dangerous waters." Additionally, the Seaman's court was concerned that interjecting tort remedies into the commercial context would seriously "intrude upon the expectations of the parties."

The court in Commercial Cotton, unfortunately, was not so concerned or cautious. It simply drew a broad analogy between the banking and insurance industries, holding that they have much in common. The court made a conclusionary statement that tort liability is proper since the relationship between banks and their depositors constitutes a "special relationship" characterized by elements of public interest, adhesion and fiduciary responsibility. It appears that Commercial Cotton was a result-oriented decision in which the court merely fashioned a decision to meet its desired goal, employing unrelated precedent to support its holding.

Insurance contracts and deposit contracts are clearly different. In Egan, the California Supreme Court held that in the insurer-insured relationship, "[i]nsurers hold themselves out as fiduciaries." The insurer enters the relationship with the insured understanding its role as the insured's fiduciary. Because of this special understanding, the supreme court held:

"[W]hen the insurer unreasonably and in bad faith withholds

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Institute, Banks and Their Borrowers: New Opportunities in Financial Services 473 (1984).

111. Seaman's, 36 Cal. 3d at 769, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63.

112. Id. Because the parties to a contract are "of roughly equal bargaining power [and] are free to shape the contours of their agreement," the supreme court stated that "it is wise to proceed with caution in determining [the] scope and application" of tort remedies in a commercial context. Id.

Lower courts have also expressed this concern over extending tort remedies into contractual disputes. For example, in Quigley v. Pet Inc., 162 Cal. App. 3d 877, 208 Cal. Rptr. 394 (1984), the owner of a trucking company brought an action against a corporation seeking to recover damages for breach of contract and tortious breach of the implied covenant of good faith and fair dealing. The court held that the plaintiff must show some "special relationship" to become an exception to the rule restricting relief to contractual damages. The Quigley court strictly construed the Seaman's language and refused to apply tort remedies. The court warned that a broad interpretation of Seaman's might deter both the undertaking of contractual obligations and the defense of one's rights in a contract suit. Id. at 889-94, 208 Cal. Rptr. at 401-04. In a similar manner, the court in Wagner v. Benson, 101 Cal. App. 3d 27, 161 Cal. Rptr. 516 (1980), noted that the standard of good faith conduct implied in a commercial contract differs from that implied in contracts for insurance. In the court's view, the scope of the duty of good faith and fair dealing was to be determined by the nature of the underlying agreement. The court held that the defendant bank's duties under the commercial loan contract did not include protecting the success of the plaintiffs' investment or disregarding its own interests; the plaintiffs were capable of and obligated to protect their own commercial interests. Id. at 33-35, 161 Cal. Rptr. at 520-21.

113. Egan, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.
payment of the claim of its insured, it is subject to liability in
tort.” For the insurer to fulfill its obligation not to impair the
right of the insured to receive the benefits of the agreement, it
again must give at least as much consideration to the latter’s
interests as it does to its own.114

The California Supreme Court has never applied such strict duties
to banks in relation to their depositors. In the bank-depositor relation-
ship, banks do not undertake or assume such obligations. Rather, banks
have relied on the established maxim that the general deposit relation-
ship is one of debtor-creditor, based on contract principles.115

b. affected with public interest?

One factor emphasized by the Commercial Cotton court was that
banks are affected with a “public interest.” The court noted that banking
is a highly regulated industry—“performing vital public services sub-
stantially affecting the public welfare.”116 However, simply being
“affected with the public interest” is not sufficient to single out a particular
industry for special treatment or imposition of fiduciary duties.117

In a 1953 contract case, the California Supreme Court stated,
“[t]here is no magic in the phrase ‘clothed with or affected with a public
interest.’ Any business is affected by a public interest when it reaches
such proportions that the interest of the public demands that it be rea-
sonably regulated.”118 In fact, nearly every aspect of daily commerce is
affected somehow with the public welfare. The concept of “affected with
the public interest” can be applied to common carriers, theaters, restaur-
ants, inns/motels, food retailers, garbage collectors, doctors and land-
lords.119 The list is virtually endless.120 Therefore, it would be absurd to

114. Id. at 818-19, 598 P.2d at 456, 157 Cal. Rptr. at 486 (quoting Gruenberg v. Aetna Ins.
Co., 9 Cal. 3d 566, 575, 510 P.2d 1032, 1038, 108 Cal. Rptr. 480, 486 (1973) (citations omit-
ted)); see also Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 460, 521 P.2d 1103, 1109, 113
Cal. Rptr. 711, 717 (1974) (the insurer “is obligated to give the interests of the insured at least
as much consideration as it gives to its own interests.”).
115. See supra text accompanying notes 37-46.
117. See State Bd. of Dry Cleaners v. Thrift-D-Lux Cleaners, 40 Cal. 2d 436, 254 P.2d 29
(1953).
118. Id. at 455, 254 P.2d at 34 (quoting Miami Laundry Co. v. Florida Dry Cleaning &
Laundry Bd., 134 Fla. 1, 183 So. 759 (1938)).
119. See F. HALL, THE CONCEPT OF A BUSINESS AFFECTED WITH A PUBLIC INTEREST
(1940).
120. For California cases construing the phrase “affected with a public interest,” see Gay
Law Students Ass’n v. Pacific Tel. & Tel. Co., 24 Cal. 3d 458, 595 P.2d 592, 156 Cal. Rptr. 14
(1979) (public utilities); Birkenfeld v. City of Berkeley, 17 Cal. 3d 129, 550 P.2d 1001, 130 Cal.
Rptr. 465 (1976) (rental housing); Orloff v. Los Angeles Turf Club, Inc., 36 Cal. 2d 734, 227
single out banks as having a "special relationship" with its customers merely because banking is "affected with the public interest."

The court in Commercial Cotton concluded that depositors depend on banks to be honest and protect the deposited funds. However, banks, like most other businesses dealing with the public, are required to carry insurance to protect the "public welfare." The public interest is adequately taken into account by the banking industry. For instance, banks insure their depositors' funds through the Federal Deposit Insurance Corporation (FDIC)121 or the Federal Savings and Loan Insurance Corporation (FSLIC).122 These entities provide coverage similar to liability insurance for manufacturers of public goods—designed to protect the "public interest."123

Banking regulation, however, does not end with FDIC. There are extensive state and federal banking regulations. For instance, Title 12 of the United States Code contains laws related to banks and banking.124 These laws were enacted to preserve the essential economic well-being of the United States, and to place constraints on the bank-depositor relationship. Two commentators have concluded:


121. The Federal Deposit Insurance Corporation (FDIC) was established as part of the Banking Act of 1933. It was created to insure deposit accounts for banks that were members of the Federal Reserve. All national banks and all members of the Federal Reserve are required to carry FDIC insurance pursuant to 12 U.S.C. § 1814(b) (1982).

122. The Federal Savings and Loan Insurance Corporation (FSLIC) was established under the National Housing Act of 1934. The FSLIC is a subsidiary of the Federal Home Loan Bank System and its policies are determined by the Federal Home Loan Bank Board. The FSLIC provides savings and loan associations and similar institutions with insurance protection for their depositors comparable to that provided by the FDIC to its insured banks. See L. RITTER & W. SILBER, PRINCIPLES OF MONEY, BANKING, AND FINANCIAL MARKETS 116 (4th ed. 1983).

123. Congress established the deposit insurance system to help restore confidence in the banking industry. The FDIC claims to owe an obligation to the entire banking community. The former chairman of the Board of Directors of the FDIC has stated, "[t]he [FDIC] ... is concerned less with keeping the insurance fund intact and more with preserving public confidence in banks." Randall, The Federal Deposit Insurance Corporation: Regulatory Functions and Philosophy, 31 LAW & CONTEMP. PROBS. 696, 702 (1966). One commentator has stated that "[t]he Federal Deposit Insurance System was established with a focus on depositors rather than financial institutions." Brooks, The Federal Deposit Insurance System: The Past and the Potential for the Future in ANNUAL REVIEW OF BANKING LAW 112 (1986). The system was designed with two "public policy" concerns in mind. First, on a small scale (micro-orientation) the system protects the individual depositor. Id. at 111. On the larger scale (macro-orientation) the system is designed to "protect communities, states, and the country against bank failures." Id. at 112. To safeguard these concerns, the insured banks are required to subscribe to extensive FDIC regulations. See 12 U.S.C. §§ 1811-1832.

The objectives of bank supervision, regulation, and insurance are to protect the safety of depositors' funds and promote a viable and smoothly functioning banking system—one that will encourage saving, channel funds from savers to borrowers, enable borrowers to get funds on reasonable terms, and foster economic stability and growth. All of this means that the objectives of bank supervision, regulation, and insurance are to make sure that banks are both safe and competitive.125

The established banking regulations already adequately protect the "public welfare." These protections, coupled with the existing common law contract and tort remedies, make it unnecessary to further impose fiduciary obligations upon the banking industry because of any "public interest" concern.

c. is the deposit contract adhesive?

The Commercial Cotton court further supported its holding that banks are under a "quasi-fiduciary" duty to its depositors by suggesting that the bank-depositor contract, like an insurance contract, is adhesive in nature. However, the contractual relationship between a bank and its depositors is similar to the relationship between many other businesses and their customers.

In Commercial Cotton, the court concluded that bank-depositor contracts are adhesive because of the gross disparity in bargaining power between banks and their depositors.126 However, this disparity exists in any consumer-seller or commercial relationship. Many plaintiffs will argue that the imposition of fiduciary obligations is appropriate whenever one party has a stronger bargaining position or greater knowledge and has the ability to reach out and exploit the weaker party. However, the California Supreme Court has never held that the ability to exploit a disparity of bargaining power is a useful test for imposing a fiduciary duty;127 "[i]f it were, the law of fiduciary relations would largely displace both the tort of fraud and much of the Commercial Code."128 Thus, the Commercial Cotton court's determination that banks are fiduciaries because the bank-depositor contract is adhesive, has no support.

The presence of competition is, in itself, a rebuttal to most disparity of bargaining power arguments. The Commercial Cotton court did not

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128. Id. at 221, 673 P.2d at 675, 197 Cal. Rptr. at 798.
seem to consider that banking is a competitive enterprise where customers have a freedom of choice. The public enjoys the protections of the free market, and banks market and administer their services to maintain good public relations in this competitive industry.

In addition to competition, the depositor is protected from possible overreaching tactics through the Uniform Commercial Code (UCC).\textsuperscript{129} The UCC defines, discusses, and governs the relationship between banks and their depositors. Banks have no ability to decrease their potential liability or exclude certain duties imposed by the UCC. For example, the UCC establishes when a bank may charge a customer’s account;\textsuperscript{130} defines a bank’s liability to the depositor for the wrongful dishonor of an item;\textsuperscript{131} describes a customer’s right to stop payment;\textsuperscript{132} and even holds the customer to a duty to discover and report unauthorized signatures or alterations.\textsuperscript{133}

The UCC therefore further defines the bank-depositor relationship and provides regulations to discourage adhesive contracts. The bank-depositor relationship has always been described as being contractual and as establishing a debtor-creditor relationship.\textsuperscript{134} Although a bank could incur tort liability through wrongful conduct, there is no authority to support the proposition that mere gross disparity of bargaining power, or unreasonable adhesiveness can be used to justify the judicially imposed fiduciary obligations that \textit{Commercial Cotton} suggests are present in the bank-depositor relationship.

3. The “quasi-fiduciary” holding in \textit{Commercial Cotton} was unnecessary and should be limited

The decision in \textit{Commercial Cotton} might have been appropriate if the court had relied solely on the “special relationship” rationale of the

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\textsuperscript{129} U.C.C. §§ 4-101-4-504.


California Supreme Court's decision in Seaman's.\textsuperscript{135} Commercial Cotton overstepped Seaman's by introducing fiduciary principles to support its decision. There was no reason for the court to hold that "[t]he relationship of bank to depositor is at least quasi-fiduciary."\textsuperscript{136} In fact, it quite simply could have been a "slip of the judicial tongue." Arguably, the court was attempting to follow the holding in Egan, that "[t]he obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary."\textsuperscript{137} The court in Commercial Cotton introduced the term "quasi-fiduciary" simply to support its finding that the bank breached its implied covenant of good faith and fair dealing when it claimed spurious defenses to avoid liability.

Soon after Seaman's, the same appellate court which decided Commercial Cotton concluded that a tort claim for bad faith breach of the implied covenant of good faith and fair dealing would lie for breach of a noninsurance contract if characteristics similar to those of insurance contracts were present.\textsuperscript{138} The court held that the following "similar characteristics" must be present to make a noninsurance contract similar enough to an insurance contract so that the "special relationship" doctrine would apply:

1. the contract must be such that the parties are in inherently unequal bargaining positions;
2. the motivation for entering the contract must be a nonprofit motivation, i.e., to secure peace of mind, security, future protection;
3. ordinary contract damages are not adequate, because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party "whole";
4. one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and
5. the other party is aware of this vulnerability.\textsuperscript{139}

Based on the foregoing test for noninsurance contracts, it is possible that the Commercial Cotton court may have had adequate grounds for

\textsuperscript{135} See supra note 92 and accompanying text.
\textsuperscript{136} Commercial Cotton, 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554 (emphasis added).
\textsuperscript{137} Egan, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487. See supra text accompanying note 102 for discussion of Egan.
\textsuperscript{138} Wallis v. Superior Court, 160 Cal. App. 3d 1109, 1119, 207 Cal. Rptr. 123, 129 (1984). Wallis involved an action by a laid off furniture employee against his former employer for terminating monthly payments agreed to in return for plaintiff's non-competition with the employer's business. The court spelled out the factors which must be present to permit a finding of tort liability in a breach of contract and covenant of good faith and fair dealing case. The court suggests that these characteristics are present in most employer-employee relationships. Id. at 1118-19, 207 Cal. Rptr. at 128-29.
\textsuperscript{139} Id. at 1118, 207 Cal. Rptr. at 129.
establishing that the bank tortiously breached its implied covenant of good faith and fair dealing based upon the existence of a special relationship. However, the court could have done so without characterizing the relationship as fiduciary or even quasi-fiduciary. By introducing the term "quasi-fiduciary," the court was apparently unaware of the ramifications that imposing this label on banks could create. This decision (or "judicial slip") has "muddied the waters" considerably for future decisions to the detriment of the entire banking industry.

B. Barrett v. Bank of America—The Bank-Borrower Relationship

In a more recent case, the same California appellate court that decided *Commercial Cotton v. United California Bank*\(^\text{140}\) followed its own precedent and dramatically extended the reach of fiduciary principles to the bank-borrower relationship. In *Barrett v. Bank of America*\(^\text{141}\) the court held that a traditional bank-borrower relationship, in addition to a bank-depositor relationship, can give rise to fiduciary obligations.\(^\text{142}\)

1. The facts

In *Barrett*, the plaintiffs (Barretts) were principal shareholders in a small electronics corporation. The Barretts obtained a $253,000 Small Business Administration (SBA) loan and a $400,000 line of credit from Bank of America. To secure these loans, the Barretts executed two personal guarantees to the bank: one in the amount of $655,000 and one on an SBA form in the amount of $253,000 secured by trust deeds on two houses. Less than a month later, the bank informed the Barretts that they were in "technical default" because their assets to liability ratio no longer conformed to the bank's requirements. Mr. Chaffee, the bank's loan officer, suggested that in order to cure the default the Barretts should bring in new investors by way of a merger or acquisition.\(^\text{143}\) Chaffee advised Barrett that "a company that merged with [Barrett's corporation] would be responsible for the loans and the Bank would release the Barretts' personal guarantees."\(^\text{144}\)

The Barretts began merger negotiations with Coded Communications (Coded), but Barrett rejected the proposals because they did not include a release of the personal guarantees. Coded finally agreed to the release six months after the closing date of the merger. Coded filed for

141. 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986).
142. *Id.* at 1369, 229 Cal. Rptr. at 20.
143. *Id.* at 1365, 229 Cal. Rptr. at 17-18.
144. *Id.*, 229 Cal. Rptr. at 18.
bankruptcy when it could no longer make payments on the Barretts' SBA loan. The bank assigned its collateral to the SBA including the Barretts' note, personal guarantee and the trust deed securing that guarantee.

The Barretts were forced to sell their home and turn over the proceeds to the SBA. As a result, the Barretts instituted an action against Bank of America alleging breach of contract, fraud, conspiracy to defraud, intentional infliction of emotional distress and negligence. The action focused on the bank's failure to honor its alleged promise to release the Barretts' personal guarantees upon the merger of their corporation with Coded.

The jury found that the Barretts reasonably believed that they would be released from the personal guarantees, and that Chaffee expressly promised they would be released after consummation of the merger. However, the jury also found in a special verdict that Chaffee did not make the assertion "in a manner not warranted by the information known to him." As a result, the trial court interpreted the special verdict "as a definitive factual finding against the [Barretts] on any fraud theory because of the absence of scienter." The trial court rejected the Barretts' request for instructions on constructive fraud.

The appellate court reversed. Notwithstanding the factual findings of the jury, the appellate court held that there was substantial evidence to support a constructive fraud theory. The court first noted that "[c]onstructive fraud usually arises from a breach of duty where a relation of trust and confidence exists." The court further stated that "[c]onfidential and fiduciary relations are in law, synonymous and may be said to exist whenever trust and confidence is reposed by one person in another." In order to link a constructive fraud theory based upon fiduciary principles to the bank-borrower relationship, the Barrett court restated its own recent holding in Commercial Cotton that "[t]he rela-

145. Id. at 1365-67, 229 Cal. Rptr. at 19.
146. Id., 229 Cal. Rptr. at 19.
147. Id.; see id. at 1367 n.2, 229 Cal. Rptr. at 19 n.2 for a discussion of the special verdict.
148. Id. at 1367, 229 Cal. Rptr. at 19.
149. Id. at 1368, 229 Cal. Rptr. at 19. The Barretts challenged the trial court verdict in favor of the bank upon the basis that the trial court should have instructed the jury on a theory of "constructive fraud." Id. at 1367-68, 229 Cal. Rptr. at 19-20. See infra text accompanying notes 159-67 for a discussion of constructive fraud.
151. Id. at 1368, 229 Cal. Rptr. at 20.
152. Id. (citing Estate of Cover, 188 Cal. 133, 143, 204 P. 583, 588 (1922)).
relationship of a bank to depositor is at least quasi-fiduciary.” The Barrett court noted that other jurisdictions recognize a similar relationship of trust and confidence between a bank and its loan customers. Therefore, the court concluded that there was sufficiently substantial evidence in this case implicating a confidential and fiduciary relationship between the bank and plaintiffs to support a constructive fraud theory. To establish such a fiduciary relationship, the court cited the following facts: that the Barretts perceived their relationship with Chaffee as a very close one, that Mr. Barrett relied upon Chaffee’s financial and merger advice and that he shared confidential financial information with the bank.

2. Critique of Barrett

The court in Barrett both affirmed and expanded upon the decision in Commercial Cotton. It determined that the relationship of a bank to its depositors and loan customers is based on trust and confidence, creating at least a “quasi-fiduciary” relationship. This relationship gives rise to a duty of full disclosure of facts which may place a bank or a third party at an advantage with respect to the customer. The Barrett court, however, misapplied both the concept of “constructive fraud” and the case law regarding the bank-borrower relationship.

a. constructive fraud

The court in Barrett applied the tort of constructive fraud to find liability on the part of Bank of America. The California Civil Code states that:

Constructive fraud consists:

1. In any breach of duty which, without an actually fraudulent intent, gains an advantage to the person in fault, or any one claiming under him, by misleading another to his prejudice, or to the prejudice of anyone claiming under him; or,

2. In any such act or omission as the law specially declares to be fraudulent, without respect to actual fraud.

155. Id.
156. Id.
157. Id. at 1370, 229 Cal. Rptr. at 20.
158. Id.
159. CAL. CIV. CODE § 1573 (West 1982).
The court employed circular reasoning to establish a constructive fraud theory. To apply constructive fraud, the court had to first find that a relation of trust and confidence existed.\(^{160}\) The court held that "[c]onfidential and fiduciary relations are in law, synonymous and may be said to exist whenever trust and confidence is reposed by one person in another."\(^{161}\) The court then reasoned that if a fiduciary relationship exists in the bank-depositor context, as it decided in *Commercial Cotton*, it should also exist in the bank-borrower relationship.\(^{162}\) Completing the syllogism, the court determined that since the Barrett-Bank of America relationship is a fiduciary one, a constructive fraud theory could be applied.\(^{163}\) This conclusion is not the result of sound reasoning.

First, the relationship between banks and their depositors is not the same as the relationship between banks and their borrowers. The two relationships require varying standards of care. The bank-depositor relationship should require a higher standard (though not a fiduciary standard) since the depositor has entrusted the bank (as a bailee) with his funds. The depositor expects the bank to disburse the funds only at his request.

In the bank-borrower relationship, the bank is relying on the borrower to repay funds the bank has entrusted to its borrower. The loan agreement is the result of an arms-length contract between the two parties where both parties expect the other to be fair and honest in their representations. There is no indication of fiduciary responsibilities on either party. The customer searches for the best interest rate possible and the bank expects to profit from the difference between the interest the bank pays to depositors and the interest the bank charges on the loan. Both parties are concerned with their own interests and are held to contractual standards of care.

Second, the Barrett court failed to realize that trust and confidence are not alone sufficient to give rise to fiduciary obligations.\(^{164}\) The Cali-

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\(^{161}\) Barrett, 183 Cal. App. 3d at 1369, 229 Cal. Rptr. at 20.

\(^{162}\) Id.

\(^{163}\) Id.

\(^{164}\) See 1 B. Witkin, *supra* note 21, § 320; *see also* Wilson v. Zorb, 15 Cal. App. 2d 526, 532, 59 P.2d 593, 596 (1936) ("It takes something more than friendship or confidence in the professional skill and in the integrity and truthfulness of another to establish a fiduciary relationship.").
California Supreme Court established that it is also necessary to show that the party in whom trust and confidence are reposed "'purports to act or advise with the other's interest in mind.'" To sustain liability on the theory of a confidential or fiduciary relationship, the record must show that the party at fault knowingly undertook to act or advise with the other's best interests. Similarly, a bank's duty to its customers should be limited to those transactions in which the bank knowingly undertook to act or advise with the borrower's best interests in mind. In Barrett, Bank of America was simply trying to protect its financial interest in the loans to the Barretts. The California Supreme Court has held that "in the absence of an acceptance of trust, which is the essence of a confidential relationship, a violation of confidence does not create a cause of action in constructive fraud." Since Bank of America did not purport to act or advise with the Barretts' best interests in mind, the court had no basis for establishing that the bank was a fiduciary, and therefore had no grounds for finding liability based on constructive fraud.

b. misapplication of case law

To support its proposition that a relationship of trust and confidence exists between a bank and its loan customers, the Barrett court cited three supreme court cases from other states. First, the court cited Klein v. First Edina National Bank, a Minnesota case, which set forth a test for determining if a bank has a fiduciary duty to disclose certain facts of a loan transaction. The test required that "special circumstances exist, such as where the bank knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank so to counsel and inform him." Thus, for a plaintiff to establish a fiduciary claim, the court must find (1) a justifiable reposing of trust and confidence and

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169. 293 Minn. 418, 196 N.W.2d 619. See supra text accompanying notes 49-53 for a discussion of Klein.
170. Klein, 293 Minn. at 422, 196 N.W.2d at 623.
confidence on the part of the plaintiff, and (2) acceptance or knowledge (or notice) of such reliance by the bank.

The second case the Barrett court cited, First National Bank v. Brown,171 did not address either of these requirements. In this Iowa Supreme Court decision, the court reasoned that bank-borrower loan agreements were not arms-length transactions, rather “there exists a relationship of trust or confidence” and the bank “has superior knowledge of the facts.”172 It is important to note that the court in Brown did not use the term “fiduciary.” The entire case was based on fraud and not breach of fiduciary duties. The court held that the bank “breached a duty to defendants which amounted in equity to fraud in the inducement, giving rise to a right of avoidance on the part of [the Browns].”173 The Brown court treated the case as a contractual dispute and looked to the principles of equitable remedies, rather than tort, to satisfy the aggrieved party. Brown can be distinguished from Barrett because the Barrett decision was not based on fraud, nor did the court fashion an equitable or contractual remedy. The Barrett court determined that tort remedies were proper based on a breach of fiduciary duties. The court in Barrett relied on Brown for support, yet employed different reasoning.

Finally, the Barrett court cited Stewart v. Phoenix National Bank174 which stated that “the relation between plaintiff [customer] and defendant [bank] was far beyond that of mere debtor and creditor.”175 However, the court did not state how far beyond debtor and creditor the relationship was. As in Brown, the Stewart court never mentioned “fiduciary” in its decision. Stewart was decided in 1937 when courts were attempting to weaken the doctrine of caveat emptor (“let the buyer beware”) and give more power to the consumer.176 Stewart represents the beginning of the courts’ attempt to change the attitudes of consumers toward commercial enterprises. The Stewart court simply raised the standard of care for banks in relation to their customers. Both Stewart and Brown can be explained under traditional fraud theories. The cases involved misrepresentation and failure to disclose material facts. These

171. 181 N.W.2d 178. See supra text accompanying notes 54-57 for a discussion of Brown.
172. Brown, 181 N.W.2d at 182.
173. Id. at 184.
174. 49 Ariz. 34, 64 P.2d 101. See supra text accompanying notes 58-62 for discussion of Stewart.
175. Stewart, 49 Ariz. at 44, 64 P.2d at 106.
176. Id. Because a bank is subject to the rules applying to confidential relations in general, it does not mean that banks cannot make a reasonable profit. “[B]ut it does mean that it cannot appeal to the doctrine of caveat emptor, and that it must disclose fairly and honestly to the client all of the facts which might be presumed to influence him in regard to his actions.” Id. at 46, 64 P.2d at 106.
opinions should not be interpreted as a foundation for establishing that banks are fiduciaries to their borrowers.

The court in Barrett should have compared its facts to those in Stenberg v. Northwestern National Bank. The Stenbergs, like the Barretts, were a married couple involved in a small business. The defendant bank made false representations to the Stenbergs regarding their loans. Nevertheless, the court in Stenberg rejected plaintiffs’ claim that a fiduciary relationship existed. The court determined that Mr. Stenberg, a businessman, was “capable of independent judgment.” The court found that the Stenbergs did not justifiably rely on the bank’s representations—they could have made their own judgments. Under the Stenberg analysis, the Barretts would have likewise been recognized as experienced business people, “capable of independent judgment.”

In Denison State Bank v. Madeira the Kansas Supreme Court further supported the Stenberg rationale by holding that “[o]ne may not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on another without a conscious assumption of such duties by the one sought to be held liable as a fiduciary.” The plaintiff in Madeira was also held to be fully competent and able to protect his own interest.

The rationale adopted in Klein, Stenberg and Madeira is more persuasive reasoning than the cases cited by Barrett. First, these cases require that the customer place a “justifiable or reasonable” trust and confidence in the bank. Second, the cases require that the bank accept, know or have reason to know that the plaintiff was placing its trust and confidence in the bank. Plaintiff thereupon brought an action against the bank. The trial court found that the bank owed the plaintiff a duty to disclose the corporation's poor financial condition at the time of the loan. Following the Klein rule, the appellate court reversed, holding that the bank had no reason to believe that the plaintiff was relying on the bank to advise and counsel him. Id. at 119. Accordingly, the court held that the bank had no fiduciary obligation to disclose to the plaintiff the financial condition of the corporation. Id. The plaintiff also failed to prove the first part of the test, that the plaintiff reasonably placed his trust and confidence in the bank or that he had relied upon the bank to counsel and inform him. Id. 181. 230 Kan. 684, 640 P.2d 1235 (1982). See supra text accompanying notes 74-81 for a discussion of Denison.

177. 307 Minn. 487, 238 N.W.2d 218 (1976). See supra text accompanying notes 71-73 for discussion of Stenberg.
178. Stenberg, 307 Minn. at 488, 238 N.W.2d at 219.
179. Id.
180. For further support of this rationale, see MacKenzie v. Summit Natl Bank, 363 N.W.2d 116 (Minn. Ct. App. 1985). In MacKenzie, the plaintiff, a corporate officer, guaranteed a bank loan to the corporation with a mortgage on his homestead. When the corporation failed to repay the loan, the bank initiated foreclosure proceedings on the plaintiff’s home. Plaintiff thereupon brought an action against the bank. The trial court found that the bank owed the plaintiff a duty to disclose the corporation’s poor financial condition at the time of the loan. Following the Klein rule, the appellate court reversed, holding that the bank had no reason to believe that the plaintiff was relying on the bank to advise and counsel him. Id. at 119. Accordingly, the court held that the bank had no fiduciary obligation to disclose to the plaintiff the financial condition of the corporation. Id. The plaintiff also failed to prove the first part of the test, that the plaintiff reasonably placed his trust and confidence in the bank or that he had relied upon the bank to counsel and inform him. Id.
183. Id.
confidence in the bank. The Barrett court recognized the existence of the first Klein requirement, but seemingly disregarded the second. The court held there was substantial evidence of a confidential relationship based on the "Barretts' perception" of their relationship with the bank. The court, however, failed to justify the Barretts' reliance. Additionally, the court never addressed the bank's acceptance or awareness of this confidential relationship. Before being held liable for breach of a fiduciary duty, the bank should be entitled to know, or at least have reason to know that they have entered into a relationship which requires such a duty.

The Barrett court should have examined cases like Klein, Stenberg and Madeira and the concept of "fiduciary" more carefully. The Barretts should not have abandoned all caution and responsibility for their own protection and unilaterally imposed a fiduciary relationship upon Bank of America without a conscious assumption of such duties by the bank. Bank of America was clearly acting out of self-interest, but at no time did it exercise undue influence over the Barretts. The Barretts were capable of protecting their own interests even if it required investigation of representations made by the bank's officer.

c. justifiable reposing of trust and confidence?

The facts in Barrett are not uncommon or unusual for bank-borrower relationships, especially where the relationship is long-standing. The borrower relied upon and trusted the bank and its representatives. Virtually every bank-borrower relationship would give rise to a fiduciary duty if all the plaintiff has to prove is that a relationship of trust and confidence existed. The Barrett court went too far in protecting the plaintiffs. The court failed to carefully consider whether the Barretts had justifiably reposed trust and confidence in the bank and whether the bank accepted such trust and confidence. Purely subjective reliance or trust alone is insufficient to establish a fiduciary relationship. Mere "friendship or confidence in the professional skill and in the integrity and truthfulness of another" is not sufficient to raise an exception to the ordinary expectation that each party to a commercial transaction will look after his own interests. There should be no duty on either party to act for

185. Fowler v. Associated Oil Co., 74 P.2d 727 (Cal. 1937) (one's implicit faith in another's honesty and integrity is insufficient to establish fiduciary relationships and sustain presumption of constructive fraud).
the benefit or protection of the other party nor to disclose facts that the other party could by its own due diligence have discovered.\textsuperscript{187} In \textit{Barrett}, the plaintiffs could have and should have further investigated the representation that they would be released from their guarantees. This representation was made by one loan officer who believed he was telling the truth. The Barretts could have easily asked for verification and authorization of this representation in writing by a higher bank official or could have consulted an attorney. The representation for release of the guarantees was significant enough to warrant diligent investigation rather than blind faith in a loan officer.

In California, courts have held that where a party "fails to pursue those facts of which he has notice, he is nevertheless held to have knowledge of each and every fact that he would have discovered had he pursued the facts he did have knowledge of."\textsuperscript{188} The Barretts had knowledge of the promised release. Accordingly, they should have pursued and investigated that fact to determine if they would actually be released of all personal guarantees upon completion of the merger. "[O]nce the plaintiff becomes aware of facts which would make a reasonably prudent person suspicious, the duty to investigate arises and the plaintiff may then be charged with the knowledge of facts which would have been discovered by such an investigation."\textsuperscript{189} The represented fact that the Barretts would be released of their personal guarantees was a significant factor of the merger agreement. Surely a reasonably prudent person would have asked for written verification of the release. Instead, the Barretts unjustifiably relied on a loan officer's oral representation.\textsuperscript{190}

The \textit{Barrett} court, by characterizing the Barretts' relationship with the bank as a fiduciary one and saddling the bank with all of the corresponding fiduciary duties, went too far in protecting the plaintiffs. "[T]he policy of the law is that he who will not reasonably guard his own interest when he has reasonable opportunity to do so, and there is no circumstance reasonably calculated to deter him from improving such

\begin{footnotesize}
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  \item[187.] See Metcalf v. Leedy, Wheeler & Co., 140 Fla. 149, 191 So. 690 (1939); Glass v. Craig, 83 Fla. 408, 91 So. 332 (1922).
  \item[190.] It seems the \textit{Barrett} court could have found Bank of America liable under "breach of contract" principles based on the bank's failure to perform its promise (oral representation) to release Barretts' personal guarantees.
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opportunity, must take the consequences." 191 The Barrett court went beyond the reasonable limits of protecting improvident plaintiffs. 192

C. Policy Implications of Commercial Cotton and Barrett

In addition to poor reasoning and scanty case support, there are several policy issues that were not addressed by the courts in Commercial Cotton Co. v. United California Bank 193 and Barrett v. Bank of America 194.

1. Conflict of interest

It is accepted in California that:

A fiduciary . . . assumes duties beyond those of mere fairness and honesty . . . he must undertake to act on behalf of the beneficiary. A fiduciary's power to transact business with his benefi-

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192. The Barrett rationale has already had some impact on lower courts. In a recent trial court decision from the Superior Court of California, County of San Diego, the trial judge found a bank liable to its customer on theories of good faith and fair dealing and breach of fiduciary duty. Security Pacific Nat'l Bank v. Williams, Nos. 457727/457728 (Cal. Super. Ct. Feb. 7, 1986). Williams, a San Diego automobile dealer, was a long-time customer of Security Pacific. Security Pacific provided Williams with special privileges for financing the dealership. Williams allegedly placed a great deal of trust in the bank and relied upon the bank's representatives to assist him with the financial management of his dealership.

In 1979, Security Pacific was looking for a new owner to take over a Los Angeles dealership where a Security Pacific loan was in jeopardy. Ross, a bank representative, indicated to Williams that he ought to purchase the dealership and made several representations to Williams about the dealership's finances. Williams purchased the Los Angeles dealership in May 1979. The gasoline crisis soon struck California. Williams was forced to release the dealership back to Chrysler's financing company by February 1980 and incurred a substantial loss from a deficiency judgment.

Because of the gasoline crisis, the entire auto industry was deteriorating. Williams moved back to his San Diego dealership which was also struggling. Security Pacific instituted restrictive financing practices to protect its security interests, forcing Williams to file for bankruptcy. Following liquidation, Security Pacific brought suit against Williams for its deficiency. Williams cross-complained on several counts, including breach of fiduciary relationship.

The trial judge held that:

[The Williams-Security Pacific National Bank [relationship] went far beyond a lender-borrower relationship. It was an all-encompassing, mutually beneficial, day-to-day relationship in which both sides reposed trust and confidence in one another. . . . The relationship here, had much the makings of a mutually beneficial partnership. Williams did in fact repose trust and confidence in the integrity and fidelity and financial judgments of these bank officers and the bank officials knew it.

Id. at 36-37.

The court awarded Williams nearly $2 million in compensatory damages and $2.5 million in punitive damages. The Williams case has been appealed.

FIDUCIARY CONTROVERSY

Fiduciary is severely limited; he must use the utmost good faith and, if he profits from the transaction, the law presumes the agreement was entered into by the beneficiary "without sufficient consideration and under undue influence." 195

Accepting this definition of "fiduciary," if *Commercial Cotton* and *Barrett* are correctly decided, banks today are faced with a serious conflict of interest because they are now forced to give priority to the interests of their depositors and borrowers. For example, as a matter of law, a bank/creditor normally has an unqualified right to call a loan and enforce collection. 196 However, when labeled as a fiduciary, it is questionable whether the bank can properly exercise this right. Banks need to protect their investment and security interests; however, if they attempt to do so they would not be looking out for the best interests of their customers.

Several courts have lost sight of the role banks play in commercial lending and deposit taking. Banks, like other commercial enterprises, engage in commercial activity for the purpose of making money. A bank's primary concern is its own financial interest, not that of its customer. The old maxim which states, "one cannot serve two masters," should be adopted in the banking industry as well as other commercial arenas. Banks cannot protect their own best interests while under a fiduciary duty to act for the benefit of the customer, giving priority to the customer's best interest. It is assumed that if a fiduciary profits from the confidential relationship—the fiduciary is exerting his influence to obtain an advantage at the expense of the confiding party. 197 Based on this rationale, it would seem impractical, and nearly impossible for an ordinary business or contractual relationship to carry with it fiduciary obligations.

Accordingly, such an obligation should not be imposed on banks in the ordinary bank-borrower or bank-depositor relationship except in rare cases. The courts in *Commercial Cotton* and *Barrett* failed to consider that extending fiduciary duties into the bank-customer relationship will

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197. Ogilvie, supra note 26, at 287.
drastically "intrude upon the expectations of the parties." The effect of the decisions could be to take the bank-customer relationship out of the "commercial realm." If regarded as a fiduciary to its customers, a bank will be forced to put its interests behind those of the customer, thereby preventing the bank from forming desirable contracts with its customers, and fulfilling its duty to bank shareholders and creditors.

There is ample authority holding that the general bank-borrower relationship is based upon contract and not fiduciary principles. It would be unfair to conclude that the bank should be placed in a fiduciary position simply because its customers allege there is a confidential or trusting relationship between themselves and the bank, that the customers relied upon the bank, or that banking is a "public service enterprise" affected with a public interest. Surely no more trust is reposed on the bank in a lending relationship than in numerous other contractual relationships—especially on the commercial level. For example, consider the following hypothetical:

Assume ABC, a prominent business machines corporation, had an ongoing relationship (about 15 years) with Ms. Wizard, owner of the small but successful Wizard Widget Corporation. Ms. Wizard had put a tremendous amount of trust in the expertise of her ABC representative, Mr. Circuit, to keep her company running smoothly with the use of up-to-date computer technology. Recently Ms. Wizard called on Mr. Circuit to determine the "best" system for her growing business, and advise her on how to finance the purchase of the system. Wizard explained in detail the company's business plans, sharing with Circuit confidential marketing and financial information. Circuit, realizing that Wizard would trust his judgment, recommended a system that was clearly inadequate for the growing needs of the Wizard Corporation. As it turns out, ABC simply wanted to unload one of last-year's systems to clear out its inventory. Wizard incurred substantial losses because the system could not keep up with her competitor's "state-of-the-art" computer system.

Does ABC owe a "fiduciary" duty to Ms. Wizard? Wizard clearly

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put all her trust and confidence in ABC, shared confidential and financial information with it, and ABC knew Wizard was relying on it. ABC intentionally and purposefully protected its own best interest by selling the "old" model. However, the answer to the question is clearly no. Wizard is adequately protected by contractual and even tort remedies for fraud. California courts have not extended fiduciary principles into this commercial realm. But, how would the court differentiate the ABC-Wizard relationship from the bank-borrower relationship? Arguably, both situations deal with apparent "unequal" bargaining positions, superior knowledge of the transaction by one party, a repose of trust and confidence by one party in the inferior position, and knowledge of that trust by the superior party. Is this enough to establish that the party in the superior position owes fiduciary obligations to the inferior party? "To adopt such a standard would put an intolerable obligation upon banking institutions and convert ordinary day-to-day business transactions into fiduciary relationships where none were intended or anticipated."2

2. Economic/public concerns

Naturally, the economic burden of the banking institution being held to such a high level of fiduciary responsibility will ultimately fall on the bank customers. As a result of the decisions in Commercial Cotton and Barrett, the entire banking industry is at a substantially greater risk. But like other industries, banks will pass the cost of this risk on to their customers. Banks will allocate this cost through higher interest rates for loans and increased administration fees.

In addition, because of the threat of potential punitive or tort damage awards arising out of alleged breach of fiduciary obligations, banks may hesitate to offer advice regarding bank loans or any other matter. There exists in banking today an overwhelming fear that a judge or jury may, in hindsight, decide that the bank owed a fiduciary obligation to its customer. As a result, customers will be less informed or perhaps uninformed of critical aspects of the nature of the loan agreement. In the bank-borrower relationship, the bank officer will decline to give any type of personal business advice for fear that the customer will claim a repossession of trust and confidence in them. Though imposition of fiduciary duties will benefit the few claiming such obligations, it appears that the public interest in banking militates against, not in favor of, holding the bank to a high level of fiduciary obligation in the bank-customer relationship.

V. Proposals

Judicial decisions, so far, have failed to provide banks with clear boundaries of acceptable conduct in their relationship with depositors and borrowers. The issues have been dealt with on a haphazard case-by-case approach—leaving banks in the unenviable position of interpretation and implementation of the varying standards and laws.

A. Strict Statutory/Common Law Protections

There are numerous statutory and common-law doctrines designed to protect the banking customer. For example, the depositor and borrower relationships are considered contractual and "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."201 Thus, courts have recently held banks liable to their customers for breach of the implied covenant of good faith and fair dealing.202 Some examples of conduct constituting bad faith include: "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance."203 This remedy sufficiently protects the customer from any overreaching and deceptive banking practices.

Historically, the bank customer has been at a relative disadvantage under our legal system. In recent years, however, numerous laws and statutes have been enacted on both the state and federal level to protect the bank customer and regulate the field of credit practices.204 The most prominent federal legislation is the Consumer Credit Protection Act.205 This Act contains provisions concerning consumer credit cost disclosure (truth-in-lending),206 credit reporting,207 discrimination in credit208 and debt collection practices.209 Banks that fail to comply with the various requirements of the state and federal regulations are liable for damages

203. Restatement (Second) of Contracts § 205 comment d.
204. F. Beutel & M. Schroeder, Bank Officer's Handbook of Commercial Banking Law (5th ed. 1982).
206. Id. §§ 1601-1667e.
207. Id. §§ 1681-1681t.
208. Id. §§ 1691-1691f.
209. Id. §§ 1692-1692o. The Act also contains provisions covering garnishment, id. §§ 1671-1677, and electronic fund transfer, id. §§ 1693-1695r.
arising from the violation, costs incurred by the aggrieved party and certain statutory penalties. In addition, "[c]laims against lenders may be asserted under the Uniform Commercial Code (UCC), the Bankruptcy Code, the federal securities laws, the tax and wage laws, and RICO." 210

These federal and state regulations do not label banks as "fiduciaries" to their deposit and loan customers. The regulations are a good example of legislative action directed at protecting consumers without imposing excessive and unwarranted duties upon the bank. The California Supreme Court has held that:

[T]he various statutory and common law doctrines fashioned to protect the consumer from overreaching and deception are strong and flexible enough to accomplish that purpose, and that it is unnecessary to call upon the law of fiduciary relationships to perform a function for which it was not designed and is largely unsuited. 211

With all the forms of protection provided for the consumer in the banking industry, it is unnecessary to look to the law of fiduciary relationships to govern an institution for which it was not designed and is highly unsuited. Courts should recognize this.

B. Banks and Customers Should Define Their Relationship

To avoid confusion, the parties to a loan transaction should explicitly state the nature of their agreement. If the customer wishes to hold the bank to a fiduciary standard of care, the bank should be aware of it. If not explicit, a practical method for a bank to avoid liability for breach of fiduciary duties is through a written agreement with the customer. For instance, within the loan/deposit documents, banks should clearly and explicitly state that they are not a fiduciary with respect to the customer. In essence, banks would be forewarning customers of the bank's position in the relationship and advising them of the bank's intention to protect its own best interests. Since the relationship between a depositor/borrower and a bank is "contractual" in nature, the parties should be free to establish or deny the existence of a fiduciary relationship between themselves by agreement. The UCC prohibits disclaimer of the good faith obligation, as well as the obligations of diligence, reasonableness and care, but provides that "the parties may by agreement determine the standards by which the performance of such obligations is to be mea-

211. Children's Television, 35 Cal. 3d at 222, 673 P.2d at 676, 197 Cal. Rptr. at 799; see supra notes 18-19 and accompanying text.
sured if such standards are not manifestly unreasonable.” 212 Even if such a provision were unreasonable and unenforceable, the provision should be considered when determining whether the customer justifiably reposed trust and confidence in the bank and whether the bank had knowledge of the customer’s reposing of trust and confidence.

A second method by which banks may protect themselves is through a jury waiver. Most of the cases in which borrowers have triumphed have been tried before a jury. Therefore, “[b]anks should consider providing for a waiver of the borrower’s right to a jury trial in the loan documents if permitted by local law.” 213 Juries have tended to favor the customer over the bank and have awarded significant damages to plaintiffs. 214 Waiver of a jury trial could be a protection for the bank from the “wave” of enormous jury verdicts.

Similarly, banks should provide in the loan agreement that any action brought by the customer against a bank will be governed by the substantive law of the bank’s home state. 215 “This is advantageous because the bank’s forms were most likely drafted to conform to the law of the state where the bank is located and the bank’s counsel is more comfortable with the laws of that state.” 216

Also, deposit and loan agreements should contain an arbitration provision. If any dispute arises between the customer and the bank, they should settle the matter through an arbitrator. Arbitrators would be much less likely to hold banks to a fiduciary standard than would a jury.

Finally, and perhaps most importantly, banks should protect themselves from imposition of unexpected fiduciary obligations through proper training of bank personnel. Banks must carefully train and advise personnel regarding what they should and should not say when dealing with a customer. Unfortunately, courts have been unclear as to when the fiduciary obligation arises, so banks are forced to be over-cautious. Until standards are established by the legislature or clarified by the courts, banks must be cautious in what they say to prevent the customer from “reposing trust and confidence” in them and establishing a basis for fiduciary obligation.

The problem today is that “[t]he growing number of lawsuits against lenders indicates that changes in the law are not always transmitted to

212. U.C.C. § 1-102(3) (1976).
213. Flick & Replansky, supra note 35, at 258.
214. See supra text accompanying notes 1-3.
215. Flick & Replansky, supra note 213, at 258.
216. Id.
those involved in making fundamental decisions.”217 A bank must be aware of the threat of liability and work diligently with its staff to reduce this potential for liability. A bank should focus on: (1) better training of staff and other personnel (including more legal education through advice of counsel); (2) careful and prudent draftsmanship of documents; (3) providing full and fair disclosures; (4) careful management of the bank loan portfolios and deposit accounts; and (5) improving information channels between bank personnel. Until specific guidelines are established by the legislature or clarified by the courts, these guidelines might assist banks in preventing the imposition of fiduciary standards during this period of uncertainty in the banking industry.

C. Proposed Guidelines

“The expanding complexity of the banking system and banking regulation and the growing competitive pressures in the banking market increase the need for specific rules of conduct. Without such rules society will accomplish little, if anything, in terms of deterrence and prevention.”218 Assuming that a bank may be regarded by the court as a fiduciary, the court must carefully describe when, where, how and why the bank becomes a fiduciary. The lawmakers should adopt tests or standards for an accurate and precise description of the bank’s duties and responsibilities to the borrower.

Since the concept of fiduciary duty is an equitable one, precise definitions and strict parameters on the relationship cannot be established for use in all cases. However, there are certain broad rules and principles which should be applied when determining whether a fiduciary relationship exists in any particular bank-borrower situation. The general test should be as follows:

A fiduciary relationship exists between a bank and its depositor or loan customer if:

(a) the customer justifiably reposes trust and confidence in the bank and reasonably believes that the bank will act, in all respects, solely to protect the customer’s interests, and will do nothing adverse to the customer’s best interests in the transaction, and

(b) the bank knows or has reason to know that the customer is reposing such trust and confidence in it, and the bank accepts this.

217. Ebke & Griffin, supra note 210, at 809.
218. Id.
From this, the court should establish standards of “justifiable” re-posing of trust and confidence, “reasonable” belief and acceptance or notice of such reliance. The standards should differ, depending on the type of customer.

1. Consumer v. commercial customers

When determining whether a customer reasonably/justifiably reposed trust and confidence in the bank, a court should differentiate between consumer and commercial customers. “A fiduciary’s duty must be defined with reference to the experience and intelligence of the person to whom the duty is owed.”

Though it is difficult to determine the subjective knowledge and understanding of a customer, there are customers who should be held to a higher standard of knowledge and understanding. For instance, the vice president in charge of finance at General Motors should be assumed to have greater knowledge of loan transactions than a consumer applying for a home improvement loan. Commercial borrowers should be held to a higher standard of knowledge and understanding because businesses are better equipped to protect themselves.

Less sophisticated consumers generally place more trust and confidence in banks than do commercial borrowers.

In several fiduciary cases in which the borrower was victorious, the borrower was a consumer. These cases emphasized that the borrower was a long-time customer and trusted the bank as a friend. In cases where the bank was victorious, the courts have held that the customer was “capable of independent business judgment.”

219. See supra text accompanying notes 185-91.
220. Midland Nat'l Bank v. Perranoski, 299 N.W.2d 404, 413 (Minn. 1980); see also First Nat'l Bank v. International Machs. Corp., 279 Minn. 188, 156 N.W.2d 86 (1968). International Machines involved a dispute between corporate officers and a bank. The court held: [A]ppellants were knowledgeable businessmen who understood the nature of the obligation which they assumed. As shareholders and directors of the corporation, it may be assumed that they benefitted directly from the loan. It cannot be denied that they knew they were to be held responsible in accordance with the terms of the instruments which they signed. Id. at 193, 156 N.W.2d at 88-89; see also MacKenzie v. Summit Nat'l Bank, 363 N.W.2d 116, 119 (Minn. Ct. App. 1985) (bank had no reason to believe that corporate officer was relying on it to advise and counsel him and, therefore, had no fiduciary obligation to disclose certain facts about transaction). See supra note 180 for a discussion of MacKenzie.
221. See supra text accompanying notes 71-73, 177-79.
223. See, e.g., Stenberg v. Northwestern Nat'l Bank, 307 Minn. 487, 238 N.W.2d 218 (1976), discussed supra at text accompanying notes 71-73, 177-79; Denison State Bank v. Ma-
tiffs in both Commercial Cotton v. United California Bank\textsuperscript{224} and Barrett v. Bank of America\textsuperscript{225} were business customers. Both plaintiffs dealt with the bank on a commercial level and should have been held to a higher standard of knowledge and understanding. Business people or commercial customers are generally able to protect themselves and are capable of exercising independent business judgment.

The author does not suggest that a bank should always be held to a fiduciary duty to its "consumers" nor does it suggest that a bank should never be held as fiduciary to "commercial" depositors and borrowers. Rather, a court should apply varying standards to determine if the customer's reposing of trust and confidence in the bank was reasonable. Then the plaintiff must satisfy the second part of the test which requires that the bank know or have reason to know that the customer was placing his trust and confidence in the bank and the bank accepts this. The burden of proof should rest on the party seeking to impose the duty. This Comment suggests that a commercial borrower's claim of "trust and confidence" should be closely scrutinized because it has "knowledge of the marketplace" and is in a better position to protect his own interests. Just as the UCC adopted separate standards for merchants and consumers, the courts or the legislature should also adopt different standards for the distinct types of bank customers.\textsuperscript{226}

VI. CONCLUSION

This Comment has demonstrated that, in recent years, the courts have struggled to apply fiduciary principles to bank-depositor and bank-borrower relationships. The fiduciary concept has been inadequately defined, in hindsight, by judges and juries. As a result, banks and their customers have been denied any type of guidelines or standards to follow which are essential in the mass handling of the millions of accounts and loans in the banking industry.

Courts and legislatures need to step back and analyze the "fiduciary" concept before introducing it into the bank-depositor or bank-borrower relationship. To carefully develop the parameters of a bank's responsibilities, the creators and interpreters of our laws need to balance

\textsuperscript{226} See, e.g., U.C.C. § 2-104 (1976).
the customer’s interest in freedom from misrepresentation and bad faith, with the bank’s interests in freedom to function in a competitive commercial market and operate in its own best interest. A bank’s liability should be kept within reasonable limits and consistent with the duties it has accepted. The ever increasing willingness to pursue new forms of commercial liability should not result in the application of a “watered down” version of established fiduciary principles. In order to avoid this impropriety, courts should refrain from injecting the law of fiduciaries into the bank-depositor and bank-borrower relationships.

Kenneth W. Curtis