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Deconstructing Corporate Governance: Director Primacy Without Principle?

René Reich-Graefe

DECONSTRUCTING CORPORATE GOVERNANCE: DIRECTOR PRIMACY WITHOUT PRINCIPLE?

René Reich-Graefe[*]

Here is my secret. It's quite simple: One sees clearly only with the heart. Anything essential is invisible to the eyes.
—Antoine de Saint-Exupéry[**]

I. OPENING SKETCHES: ABSOLUTE DIRECTOR PRIMACY

For almost eighty years now, corporate law scholarship has centered around two elementary analytical findings made in what has once been described as the "last major work of original scholarship"[1] within the field. Since Adolf Berle and Gardiner Means' *The Modern Corporation and Private Property*,[2] corporate theory has first regarded the separation of ownership and control (*i.e.*, the defining notion characterizing the large, publicly held corporation with widely dispersed shareowner-

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* Associate Professor of Law, Western New England College School of Law. LL.B., Free University of Berlin School of Law, 1996. LL.M., University of Connecticut School of Law, 1997. I am grateful for generous financial support from the Western New England College School of Law and for helpful comments and support from Barbara Noah (who also made sure that I broke up and changed all of those long sentences that each ran for an entire paragraph). All errors are mine (and any remaining single-sentence paragraphs were reinserted later due to my stubbornness).

** THE LITTLE PRINCE 63 (Richard Howard trans., Harcourt 2000) (1943).

1. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984). *See also* STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 4-5 (2008) (describing Berle and Means' *The Modern Corporation and Private Property* as "what still may be the most influential book ever written about corporations").

2. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

ship)[3] as the "master problem for research."[4] As a second analytical inquiry, it has designated the resultant problem of affecting control over independent corporate managers through both legal and market forces as the fundamental agency (cost) problem of corporate law.[5]

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3. *See id.* at 84-89, 119-25. *Accord* FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT 291 (1921) ("The typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control."). *See also* STEPHEN M. BAINBRIDGE, CORPORATE LAW 3-5, 72 (2d ed. 2009) [hereinafter, BAINBRIDGE, CORPORATE LAW]; JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 39-40 (2d ed. 2003); Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW. 45, 46 (2002) [hereinafter Bainbridge, *Director v. Shareholder Primacy*]; William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 739-40, 753-59 (2001); Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 303 n.9 (1993) [hereinafter Hart, *An Economist's View*]; David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 214; Charles R.T. O'Kelley, *The Entrepreneur and the Theory of the Modern Corporation*, 31 J. CORP. L. 753, 754 (2006) [hereinafter O'Kelley, *The Entrepreneur*]; Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. 257, 259-60 (2010). On the legacy of Berle and Means and their groundbreaking research, see generally Kelli A. Alces, *Revisiting Berle and Rethinking the Corporate Structure*, 33 SEATTLE U. L. REV. 787 (2010); Bratton, *supra*; William W. Bratton, Jr. & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99 (2008); William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of* The Modern Corporation*'s Last Chapter*, 33 SEATTLE U. L. REV. 849 (2010); Charles R.T. O'Kelley, *Berle and the Entrepreneur*, 33 SEATTLE U. L. REV. 1141 (2010); Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247 (2010).

4. Romano, *supra* note 1. *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 3-4 (stating that "[t]he conflicts of interest created by [the] separation of ownership and control drive much of corporate law"); BAINBRIDGE, *supra* note 1, at 6 (discussing the effects of the separation of ownership and control); Alces, *supra* note 3, at 787 (describing the separation of ownership and control and the resultant agency cost problem as "a central concern of the law of corporate governance"); *id.* at 789 (describing the separation of ownership and control as "the defining problem facing corporate governance"); O'Kelley, *The Entrepreneur, supra* note 3, at 754 (stating that the "central problem of the modern corporation" is found in its "separation of ownership and control"); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 740 (1997) ("The essence of the agency problem is the separation of management and finance, or – in more standard terminology – of ownership and control.").

5. *See*, *e.g.* BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 75 ("Much of corporate law is best understood as a mechanism for containing […] agency costs."); Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743, 743 (1999) [hereinafter Blair & Stout, *Team Production*]

The latter problem of efficient corporate control, in particular (*i.e.*, that magical—if, perhaps, elusive—balance between managerial discretion and managerial accountability),[6] must be regarded, at least analytically, as "unfinished business." *Solvitur ambulando*,[7] we have certainly made good progress "stumbl[ing] forwards in our empirical fashion"[8]

(describing the agency cost problem of monitoring managers and motivating them to act as faithful agents as "the central economic problem to be faced in a public corporation" for those following the principal-agent model of the firm); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1807 (2001) [hereinafter Blair & Stout, *Trustworthiness*]; Phillip I. Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B.U. L. REV. 157, 177 (1970); Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 21, 22 (2004); Marcel Kahan, *The Limited Significance of Norms for Corporate Governance*, 149 U. PA. L. REV. 1869, 1877-78 (2001); Millon, *supra* note 3, at 221; Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1624 (2001); Shleifer & Vishny, *supra* note 4, at 740-48 (discussing the agency problem as the central problem of corporate governance). *See also* Rudolf Richter, *The New Institutional Economics: Its Start, Its Meaning, Its Prospects*, 6 EUR. BUS. ORG. L. REV. 161, 179 (2005) (stating that the central problem of Williamsonian transaction cost economics is ex-post opportunism).

6. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 207 (2002) [hereinafter BAINBRIDGE, CORPORATION LAW AND ECONOMICS] ("Establishing the proper mix of discretion and accountability […] emerges as the central corporate governance question."); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 84 (2004) [hereinafter Bainbridge, *Abstention Doctrine*]; Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 524-25 (1992); Darian M. Ibrahim, *Individual or Collective Liability for Corporate Directors*, 93 IOWA L. REV. 929, 947-48 (2008); Pinto, *supra* note 3, at 266; Shleifer & Vishny, *supra* note 4, at 742-44.

7. "It is solved in walking":

> A civilian system differs from a common law system much as rationalism differs from empiricism or deduction from induction. The civilian naturally reasons from principles to instances, the common lawyer from instances to principles. The civilian puts his faith in syllogisms, the common lawyer in precedents; the first silently asking himself as each new problem arises, "What should we do this time?" and the second asking aloud in the same situation, "What did we do last time?" . . . The instinct of the civilian is to systematize. The working rule of the common lawyer is *solvitur ambulando*.

Thomas Mackay Cooper, *The Common Law and the Civil Law—A Scot's View*, 63 HARV. L. REV. 468, 470–71 (1950).

8. Frederic W. Maitland, *Outlines of English Legal History, 560-1600*, *in* II THE COLLECTED PAPERS OF FREDERIC WILLIAM MAITLAND 438–39 (H.A.L. Fisher ed., 1911). Maitland famously characterized the methodological approach of the English

and have been successful at developing a good number of insightful and valuable microtheoretical[9] models of the firm[10] but, as I have analyzed

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common law as follows:

> King Henry and his able ministers came just in time—a little later would have been too late: English law would have been unified, but it would have been Romanised. We have been wont to boast, perhaps too loudly of the pure 'Englishry' of our common law. This has not been all pure gain. Had we 'received' the Roman jurisprudence as our neighbours received it, we should have kept out of many a bad mess through which we have plunged. But to say nothing of the political side of the matter, of the absolute monarchy which Roman law has been apt to bring in its train, it is probably well for us and for the world at large that we have *stumbled forwards in our empirical fashion, blundering into wisdom.*

Id. (emphasis added). *See also* RAINER MARIA RILKE, RILKE ON LOVE AND OTHER DIFFICULTIES 25 (John L. Mood, trans., W.W. Norton 1975) ("Do not now seek the answers, which cannot be given you because you would not be able to live them. And the point is, to live everything. *Live* the questions now. Perhaps you will then gradually, without noticing it, live along some distant day into the answer.").

9. Microtheoretical models of the firm focus on the internal cohesion, adaptability and survival of the firm as a generator and maximizer of productive output and economic wealth and, thus, largely ignore distributive concerns—namely, whether the externalized costs of generating and maximizing economic wealth are fairly/effectively distributed and whether the resultant economic wealth itself is fairly/effectively distributed. *Cf.* William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1396 (1993); Millon, *supra* note 3, at 201-02; Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law: Introduction*, 149 U. PA. L. REV. 1607, 1608 (2001).

10. The four main models in today's academic discussion can be labeled as "shareholder primacy," "contractarian," "team production," and "director primacy." *See, e.g.*, Bainbridge, *Director v. Shareholder Primacy*, *supra* note 3 (discussing shareholder-primacy and director-primacy models); John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Corporations?*, 24 J. CORP. L. 837 (1999) (discussing team-production models); George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213 (2008) (discussing team-production and director-primacy models); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006) (discussing shareholder-primacy models); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533 (2006) (discussing shareholder primacy and team production models); René Reich-Graefe, *Deconstructing Corporate Governance: Absolute Director Primacy*, 5 BROOK. J. CORP. FIN. & COM. L. 341 (2011) (discussing all four models); J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 315-26 (2010) (discussing all four models as well as 'agency theory' and 'progressive corporate law theory'). For a more general discussion of those firm models, see also Melvin A. Eisenberg, *The Conception that the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999); O'Kelley, *The*

in more detail elsewhere,[11] we are still a significant distance away from fully explaining "the wisdom" that Berle and Means so thoroughly and masterfully "blundered into."[12] Measured by the predictive ability and accuracy of such models[13] (*i.e.*, their respective ability to predetermine

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Entrepreneur, *supra* note 3; Steven M.H. Wallman, *Understanding the Purpose of a Corporation: An Introduction*, 24 J. CORP. L. 807 (1999) [hereinafter Wallman, *Understanding*].

11. Reich-Graefe, *supra* note 10.

12. *See* Maitland, *supra* note 8, at 439. *See also* Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 832 (2001) ("Until we discover exactly what directors hear amidst all the noise, we cannot begin to evaluate the *wisdom* of our bundle of legal and regulatory strategies touching on questions of boards of directors' responsibilities.") (emphasis added). For the so-called "Berle-Dodd debate" between Adolf A. Berle, Jr. and E. Merrick Dodd, Jr. in the wake of the Great Depression and their dialectic development of fiduciary duties and, thus accountability, of corporate managers, see Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); Adolf A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1935). *See generally* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 273 (1992) (discussing the Berle-Dodd debate); William W. Bratton, Jr. & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 122-34 (2008) (same); Fisch, *supra* note 10, at 646-48 (same); A.A. Sommer, Jr., *Whom Should The Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33 (1991); Lynn A. Stout, *On the Proper Motives of the Corporate Directors (Or, Why You Don't Want to Invite Homo Economicus to Join Your Board)*, 28 DEL. J. CORP. L. 1, 22 (2003) [hereinafter Stout, *Proper Motives*] ("The debate between the 'shareholder primacy' view and 'stakeholder' models of the corporation dates back at least seventy years, and it remains unresolved today.") (footnote omitted); Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964). In an interesting twist to today's prevailing views on shareholder primacy, Berle explicitly conceded defeat of his shareholder primacy model to Dodd's stakeholder-oriented model once *A.P. Smith Manufacturing Co. v. Barlow*, 98 A.2d 581 (N.J. 1953), was decided. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954). *See also* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 561 n.70 (2003) [hereinafter Bainbridge, *Primacy*].

13. Predictive ability and accuracy is, of course, the main criterion by which positive (descriptive) economic models are evaluated. *See, e.g.*, Milton Friedman, *The Methodology of Positive Economics*, *in* ESSAYS IN POSITIVE ECONOMICS 3, 11-12 (1966); THE PHILOSOPHY OF ECONOMICS: AN ANTHOLOGY 180, 186 (Daniel M. Hausman ed.,

both investor and manager behavior subject to an ambient mix of motives, incentives, aspirational legal mandates[14] and market forces[15]), we have been stuck at a crossroads for some time now. Descriptively, we have been able to design coherent models of the firm that explain current corporate reality (but for some "second- or third-order quibbling"[16] that

2d ed. 1984) ("But economic theory must be more than a structure of tautologies if it is able to predict and not merely describe the consequences of action; if it is to be something different from disguised mathematics.") (footnote omitted); Fred S. McChesney, *Positive Economics and All That*, 61 GEO. WASH. L. REV. 272, 278 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991)) ("Positive economics submits itself to the rigor of scientific method. Submission means that the model's value is to be judged not only by its internal consistency and adherence to accepted principles, but also by its ability to predict the occurrence of events in the real world. It must be possible to derive from the model behavioral implications, at least some of which must be empirically falsifiable and therefore testable."); Fred S. McChesney, *The "*Trans Union*" Case:* Smith v. Van Gorkom, *in* THE ICONIC CASES IN CORPORATE LAW 231, 253 (Jonathan R. Macey ed., 2008); O'Kelley, *The Entrepreneur*, *supra* note 3, at 755, 757. *See also* BAINBRIDGE, *supra* note 1, at 2-3; Stephen M. Bainbridge, *Competing Concepts of the Corporation (A.K.A. Criteria? Just Say No)*, 2 BERKELEY BUS. L.J. 77, 81 (2005) [hereinafter Bainbridge, C*ompeting Concepts*]; Lawrence E. Mitchell, *The Importance of Being Trusted*, 81 B.U. L. Rev. 591, 596 (2001) [hereinafter Mitchell, *Trusted*].

14. Bainbridge, *Abstention Doctrine*, *supra* note 6, at 89 n.37; Julián Javier Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders – A Comparative Study*, 31 ST. MARY'S L.J. 613, 629 (2000); Ibrahim, *supra* note 6, at 934; Mitchell, *Trusted*, *supra* note 13, at 613; Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1015 (1997); Rock & Wachter, *supra* note 9, at 1608. *See also* Edward B. Rock & Michael L. Wachter, *Corporate Law as a Facilitator of Self Governance*, 34 GA. L. REV. 529, 529 (2000) [hereinafter Rock & Wachter, *Corporate Law as a Facilitator*] ("[O]ne should think of fiduciary duty cases as judicial sermons that exhort managers to consummate performance and that criticize those who perform below expectations, even if, or perhaps especially when, no direct legal sanction is imposed.") (footnote omitted).

15. *See*, *e.g.*, Bainbridge, *Primacy*, *supra* note 12, at 562; Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. CORP. L. 719, 724 (2006); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 252 (1999) [hereinafter Blair & Stout, *A Team Production*]; Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 119-20 (2006); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965); Millon, *supra* note 3, at 230; Pinto, *supra* note 3, at 276-79.

16. Roberta Romano, *What is the Value of Other Constituency Statutes to Shareholders?*, 43 U. TORONTO L.J. 533, 534 (1993); *see also* J. Mark Ramseyer, *Economizing Legal D-B8*, 2 BERKELEY BUS. L.J. 25, 29 n.12 (2005) ("Waffling is obligatory to

remains). Normatively, however, our models operate in a large conceptual vacuum (or "black box"). We are regularly presupposing an unacknowledged "something" that is currently largely unexplained and unaccounted for—something that, for lack of a better general term, I call "protolegal variables"[17]—in order to control for both managerial behavior and the microtheoretical models of the firm that attempt to describe and predict such behavior.

In a related article,[18] I have developed an *absolute director primacy model* of the firm that has led me—at least, tentatively and for the time being—to two conclusions and one dilemma. First, I concluded that the board of directors of a Berle-Means corporation is the private-sector equivalent of a modern *Leviathan*.[19] The board itself, not shareholders on aggregate nor the corporation, is the corporate sovereign—both *de facto* and *de jure*. Its decisionmaking is by fiat[20] and its decisionmaking authority to run the corporation's business and affairs as it sees fit is absolute,[21] original,[22] infinite[23] and, thus, *sui generis*[24] (hence the moniker

law-review writing. I actually think it's better. Probably.")

17. By "protolegal variables," I mean all those socio-contextual, behavior-oriented, and reciprocal normative implications and foundations of interpersonal cooperation which are based on "expectations," "counter-expectations," and "expectation-expectations." *See infra* Parts IV-V.

18. Reich-Graefe, *supra* note 10.

19. *Cf.* Allen, *supra* note 9, at 1396 ("Under the liberal-utilitarian model, the law creating and protecting property rights and the law enforcing contracts is the law of greatest importance to our welfare. The legal value of the highest rank in this classical liberal view is, I suppose, human liberty, and the greatest evil is oppression by the leviathan state.") (footnote omitted).

20. Such authoritative decisional determination by the board is—in the genuine meaning of the term "fiat"—both dictatorial and, *ipse dixit*, valid. It is non-reviewable and, *ipso facto*, irrebuttably assumed to be right (which, of course, is exactly the effect of the courts' applications of the business judgment rule). *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule exists to protect and promote full and free exercise of the managerial power grant to Delaware directors.") (citation omitted); BAINBRIDGE, *supra* note 1, at 38-45.

21. *See* HOWARD H. SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTIONS 4-5 (1931) ("[M]odern decisions tend toward an emphasis of the directors' *absolutism* in the management of the affairs of large corporations; the board of directors has achieved a super-control of corporate management and of the corporation's legal relations . . . .") (emphasis added); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 214 (1985) ("But modern corporate legislation, passed during the first quarter of the twentieth century, ratified a new '*absolutism*' that courts themselves had already begun to

"absolute director primacy").[25] Comparable to the Hobbesian perpetual

bestow upon corporate directors.") (emphasis added); *see also* Blair & Stout, *A Team Production*, *supra* note 15, at 251 (stating that at the peak of the corporate hierarchy "sits a board of directors whose authority over the use of corporate assets is virtually absolute").

22. *Cf.* Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918); Burrill v. Nathant Bank, 2 Met. (Mass.) 163, 166-67 (1840); BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 74; ROBERT C. CLARK, CORPORATE LAW 22 (1986) ("The model behind corporate law's treatment of authority is one of a unilaterally controlled flow of authority from a single wellspring of power rather than a bubbling up and flowing together of many individual sources of personal power. The state has power; it chooses to delegate it to the board of directors of a corporation."); Horwitz, *supra* note 21, at 216.

23. *Cf.* Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185, 190 (Lawrence E. Mitchell ed., 1995) [hereinafter Mitchell, *Trust*] ("The power and control that are present in all fiduciary relationships is exaggerated in the corporation where the indeterminate length of the enterprise and the practically infinite array of investment opportunities for the corporation make any possibility of specified limitations on directors' power or ongoing control by the stockholders unrealistic.").

24. *Sui generis* decisionmaking authority of corporate directors means that their decisionmaking power is non-derivative. In particular, shareholder primacy models incorrectly assume that the decisionmaking authority of corporate boards is derivative, i.e., delegated to corporate boards by the shareholder franchise—at least, through the mechanism of board elections during which shareholders vote. This assumption ignores the *de lege lata* reality of board authority. *See supra* note 29 and accompanying text*; see also* Dooley, *supra* note 6, at 467 (describing the problem of allocating authority within the corporate firm as "the universally recognized requirement for the establishment of, and vesting of *supreme* authority in, the board of directors") (emphasis added); Horwitz, *supra* note 21, at 214 ("At some point at the beginning of the twentieth century, American legal opinion began decisively to shift to the view that 'the powers of the board of directors … are identical with the powers of the corporation.' Earlier, the dominant view, as expressed by the United States Supreme Court, was that 'when the charter was silent, the ultimate determination of the management of the corporate affairs rests with its stock holders.'") (footnotes omitted).

25. *Cf.* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 6 (explaining the director primacy model developed by Professor Bainbridge); BAINBRIDGE, *supra* note 1; Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002); Bainbridge, *Abstention Doctrine*, *supra* note 6; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006); Bainbridge, *Competing Concepts*, *supra* note 13; Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791 (2002); Bainbridge, *Primacy*, *supra* note 12; Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, 1 J. BUS. & TECH. L. 335 (2007); Stephen M. Bainbridge, Unocal *at 20: Director Primacy*

bellum omnium contra omnes within the sovereign state,[26] I have argued that the corporate entity is inescapably and insolubly characterized by perpetual conflicts among self-interested corporate constituents.[27] To manage those conflicts—which present a perennial, systemic risk to the internal cohesion, adaptability and, thus, prosperity and ultimate survival of the firm—corporate law is necessarily called upon to allocate infinite and absolute decisionmaking authority within one core group of corporate constituents.[28] American corporate law is unmistakably clear as to the identity of such single core group of corporate constituents—namely, the corporation's board of directors.[29] As a result, I have argued that the well-advised, disinterested corporate board of a Berle-Means corpora-

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in Corporate Takeovers, 31 DEL. J. CORP. L. 769 (2006); Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002); Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183, 196-98 (2004).

26. *See* THOMAS HOBBES, LEVIATHAN OR THE MATTER, FORM & POWER OF A COMMONWEALTH, ECCLESIASTICAL AND CIVIL, ch. 13 (1651) ("Hereby it is manifest, that during the time men live without a common power to keep them all in awe, they are in that condition which is called war; and such a war, as is of every man, against every man."); *cf.* Peter J. Burke & Jan E. Stets, *Trust and Commitment Through Self-Verification*, 62 SOC. PSYCHOL. Q. 347, 347 (1999).

27. Reich-Graefe, *supra* note 10.

28. *See* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 69 (1974) ("Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success."); Allen, *supra* note 9, at 1400; Bainbridge, *Primary*, *supra* note 12, at 552; Dooley, *supra* note 6, at 466; *see also* Rock & Wachter, *supra* note 5, at 1621.

29. DEL. CODE ANN. tit. 8, § 141(a) (2010). *See also* REV. MODEL BUS. CORP. ACT § 8.01(b) (ABA 1984) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors . . . ."). Under the corporation statutes of all states, corporations are managed by or under the direction of a board of directors as the statutory default rule. *See*, *e.g.*, Dent, *supra* note 10, at 1216 (2008); Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 92 (2004); Ribstein, *supra* note 25, at 188. *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 72 (stating that (i) shareholders have "virtually no power to control" the business and affairs of the corporation, (ii) the board of directors and senior management "effectively controls," and (iii) "[a]s a doctrinal matter, moreover, corporate law essentially carves this separation into stone"); COX & HAZEN, *supra* note 3, at 149 (stating that the board of directors "is legally the supreme authority in matters of the corporation's regular business management"); Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 STETSON L. REV. 925, 925 (2004) ("Around the world, the legal norm is that corporations are managed by, or under the direction of, a board of directors.") (footnote omitted).

tion is uncontrollable in absolute terms.[30] In other words, my *absolute director primacy model*—unlike all other microtheoretical models of the firm—explicitly denies that any meaningful measure of director accountability exists in American corporate law.[31]

After having allocated absolute, original, infinite and *sui generis* authority for making adaptive decisions for purposes of firm sustainability in a core group of decisionmakers, my second conclusion concerned the end (rather than the means) of any corporate governance system.[32] Not only should such a system allocate authority and discretion for making adaptive decisions on behalf of the firm,[33] it should also define, if possible, the norms and interests that should guide the internal decisionmakers in their decisionmaking.[34] Otherwise, any exercise of deci-

30. Reich-Graefe, *supra* note 10.

31. It should be noted that this statement is only made with regard to the agency (cost) problem of directorial shirking, not the more controlled and controllable agency (cost) problem of directorial stealing. In other words, directors are granted full discretion to act opportunistically—unfettered by any *ex-ante* or *ex-post* legal constraint—and to favor any particular cause or firm participant interest over any and all others at any point in time as long as (i) no controlling economic self-interest of directors is actualized (and remains unsanitized) in the decision, (ii) very minor and basic process due care is complied with, and (iii) some rudimentary (and, possibly, entirely hypothetical) rational basis and explanation can be construed as to why the prevailing consensus at the time of the board action might have been that the corporation could ultimately benefit in some (tangible or intangible) shape or form. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 110 (concluding that pursuant to the effects of the business judgment rule, corporate directors are given "carte blanche to make decisions that might turn out badly, but no discretion to make selfish decisions"); Blair & Stout, *Team Production*, *supra* note 5, at 746 (stating that, as a matter of law, corporate directors remain "insulated from the direct command and control of [shareholders] or any other corporate constituents"); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1470 (2006); Stout, *Proper Motives*, *supra* note 12, at 6 (stating that the business judgment rule "allows a director who makes even a minimal effort to become "informed" to make foolhardy decisions all day long, without fear of liability").

32. *Cf.* Bainbridge, *Primacy*, *supra* note 12, at 552.

33. *Cf.* Dooley, *supra* note 6, at 466; Susanna K. Ripken, *Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 FORDHAM J. CORP. & FIN. L. 97, 127-28 (2009) (discussing the treatment of the corporation's internal decision structure (CID Structure) as developed by philosopher Peter French; *see* PETER A. FRENCH, COLLECTIVE AND CORPORATE RESPONSIBILITY (1984); Peter A. French, *The Corporation as a Moral Person*, 16 AM. PHIL. Q. 207 (1979)).

34. *See*, *e.g.*, Allen, *supra* note 9, at 1400; Bainbridge, *Primacy*, *supra* note 12, at 552; Dooley, *supra* note 6, at 466. *See also* Rock & Wachter, *supra* note 5, at 1621.

sionmaking authority would *always* be arbitrary: an uncontrollable board of directors would also always be an out-of-control board of directors.

However, here I argue that there are no recognizable and enforceable decision-guiding norms or principles within our current American corporate law as it is written. Accordingly, if, pursuant to my first conclusion above, I deny the existence of any *ex-post-investment* director accountability in American corporate law, I logically end up now with my second conclusion that denies the existence of any *ex-ante-investment* determinability of director behavior. Corporate law does not define the ends of corporate governance. It only builds an aspirational and indeterminate profit-seeking motive into the corporate entity.[35] Whether and how directors will, in fact, seek overall profitability remains anyone's guess. Furthermore, how directors can be motivated to seek (optimal) profitability remains a mystery.

If these two conclusions were absolutely true, however, no rational investor would be participating in a firm knowing that its central decisionmaker can always act arbitrarily and always get away with it.[36] Thus, I posit that the extent to which the board of directors as sovereign may exercise its absolute, original, infinite and *sui generis* authority on behalf of the corporation must be conditional on, and controlled by "something"—"something" that, within current microtheoretical models of the firm, is logically indeterminable.[37] Therefore, I argue that we need to consider model-transcending protolegal variables (for example, any applicable moral obligations)[38] and explain their external, exogenous influence[39] over current microtheoretical models of the firm[40] in or-

35. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) ("Corporate managers have never had an enforceable legal duty to maximize corporate profits."); Rock & Wachter, *supra* note 5, at 1643-44.

36. *Cf.* Schlanger v. Four–Phase Systems Inc., 555 F. Supp. 535, 538 (S.D.N.Y.1982) (stating with regard to investors who trade shares in well-developed markets in reliance on the integrity of the price set by the market that ''it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?"). I argue that the same investors also rely on at least some minimum "floor" of integrity of corporate directors and the resultant robustness of their decision-making—both in process and in substance.

37. Reich-Graefe, *supra* note 10.

38. In the parlance of economics, there is, however, the risk that these variables turn out to be "observable, but not verifiable." *See* Oliver Hart, *Norms and Theory of the Firm*, 149 U. PA. L. REV. 1701, 1702 (2001) [hereinafter Hart, *Norms and Theory*]; Rock & Wachter, *supra* note 9, at 1617.

39. *Cf.* Hart, *Norms and Theory*, *supra* note 38, at 1702.

der to properly model the firm-internal intricacies of corporate governance with sufficient predictive ability.

Finally, all of the above presents the *absolute director primacy model* with an immediate dilemma:[41] the board of directors in a Berle-Means corporation is not only autocratic, but it can also be totalitarian if, when and where it so pleases.[42] As a matter of corporate law, the board of directors is akin to an "unguided missile." There are no recognizable decision-guiding norms or principles—either enforceable[43] or aspirational[44]—within our current American corporate law as it is written. It seems that the inner intelligibility of our corporate law aspires to be intentionally and purposefully unspecified and diffuse.[45] Inevitably,

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40. *Cf.* Allen, *supra* note 9, at 1397 (describing how proponents of the social model of human interaction see the utility of law resting "in part on presupposition of shared norms including those of fairness and trust").

41. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1807 (calling this dilemma a "riddle" of corporate law); Stout, *Proper Motives*, *supra* note 12, at 8 (describing this dilemma as a "basic mystery").

42. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1791 ("The net result is that, as a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting than she is to pay damages."); Jones, *supra* note 15, at 117 ("Independent directors face an infinitesimal risk of paying personally for damages to the corporation caused by their breach of fiduciary duty."); Mitchell, *Trust*, *supra* note 23, at 190 (stating that "directors have largely unlimited power over the corporation and its affairs"); Stout, *Proper Motives*, *supra* note 12, at 6 ("The business judgment rule . . . allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability."); *id.* at 7 ("[I]t is only a slight exaggeration to suggest that a corporate director is statistically more likely to be attacked by killer bees than she is to have to ever pay damages for breach of the duty of care."). *See also* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 242 (2009) ("It is dangerous and costly to assume that fiduciary duties function well in the corporate context. The assumption may give shareholders a false sense of security or a belief that they are able to discipline management effectively when in fact, because of the very limited nature of corporate governance duties, they are not.").

43. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 614.

44. Bainbridge, *Abstention Doctrine*, *supra* note 6, at 89 n.37; Garza, *supra* note 14, at 629; Ibrahim, *supra* note 6, at 934; Mitchell, *Trusted*, *supra* note 13, at 613-14; Rock, *supra* note 14, at 1015; Rock & Wachter, *supra* note 9. *See also* Rock & Wachter, *Corporate Law as a Facilitator*, *supra* note 14. ("[O]ne should think of fiduciary duty cases as judicial sermons that exhort managers to consummate performance and that criticize those who perform below expectations, even if, or perhaps especially when, no direct legal sanction is imposed.") (footnote omitted).

45. *Cf.* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L. Q. 403, 436 (2001) ("As a solu-

boards can be opportunistic and generate substantial, entirely uncontrollable economic agency costs for the investment positions of other firm participants within the corporate wealth-generation structure.[46] Correspondingly, as an investor, one seems to be relegated to only something like "hope"[47] (or—more to the point—"trust," "loyalty" and similar socio-contextual,[48] behavior-oriented and reciprocal[49] variables[50] based on pre-coded expectations and counter-expectations and aimed at reducing social complexity[51]) that directors know what they do, that they have in-

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tion to the contracting problems associated with team production, the mediating board is obviously messy.").

46. *See* Stout, *Proper Motives*, *supra* note 12, at 4 (stating that, if we only consider financial rewards to directors, i.e., make assumptions based only on rational selfish behavior of directors, "directors seem to have little reason to break a sweat in the boardroom").

47. *Cf. id.* at 18 (stating that "we must inevitably rely on directors' internalized sense of responsibility as their primary if not their *sole* motive for exercising judgment and care") (emphasis added).

48. *See id.* at 13.

49. *Cf.* Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSP. 159, 159 (2000) ("Reciprocity means that in response to friendly actions, people are frequently much nicer and much more cooperative than predicted by the self-interest model; conversely, in response to hostile actions they are frequently much more nasty and even brutal.").

50. *See*, *e.g.*, Allen, *supra* note 9, at 1402 (trust, loyalty); Bainbridge, *Primacy*, *supra* note 12, at 551 n.21 (guardianship, duty); Dent, *supra* note 10, at 1221 (trust); Hart, *An Economist's View*, *supra* note 3, at 306 (reputation, integrity); Hart, *Norms and Theory*, *supra* note 38, at 1702 (honesty, trust); *id.* at 1703 (decency, fairness); *id.* at 1714 (reputation, trustworthiness); Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. L. 869 (1999) [hereinafter Mitchell, *Trust and Team*] (trust, loyalty, duty); O'Kelley, *The Entrepreneur*, *supra* note 3, at 767 (integrity); *id*. at 769 (confidence); Rock & Wachter, *supra* note 9, at 1608 (corporate culture); *id.* at 1609 (trust); *id.* at 1611 (credibility); *id.* at 1613 (reputation); D. Gordon Smith, *Team Production and Venture Capital Investing*, 24 J. CORP. L. 949, 969 (1999) (firm reputation); Stout, *Proper Motives*, *supra* note 12, at 1 (altruism); *id.* at 7 (reputation); *id.* at 8-9 (sense of honor, responsibility, sense of obligation; integrity, trustworthiness); *id.* at 20 (character).

51. *Cf.* NIKLAS LUHMANN, LOVE AS PASSION: THE CODIFICATION OF INTIMACY (Jeremy Gaines & Doris L. Jones trans., 1986); NIKLAS LUHMANN, RISK: A SOCIOLOGICAL THEORY (Nico Stehr & Gotthard Bechmann trans., 1993); NIKLAS LUHMANN, SOCIAL SYSTEMS (John Bednarz, Jr. & Dirk Baecker, trans., 1995); NIKLAS LUHMANN, TRUST AND POWER 69 (Howard Davis et al. trans., 1979); Niklas Luhmann, *Familiarity*, *Confidence*, *Trust: Problems and Alternatives*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 94, 97 (Diego Gambetta ed., 1988) [hereinafter Luhmann, *Familiarity*] ("You cannot live without forming expectations with respect to contingent

ternalized the correct moral compass,[52] and, thus, using such compass, will "do the right thing"[53] more often than not.[54] However, hope—as a form of nonrational, intuitive confidence in particular outcomes that is designed to avoid the rational analysis of, and confrontation with, the consequences of current actions—does not appear to be something that we can and should accept as a satisfactory explanation and basis for the daily phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment*.[55] The inquiry thus becomes: if profit-maximizing is not enforced by corporate law,[56] why does it nonetheless happen as a matter of almost overwhelming routine in today's corporate reality?[57] If indeed, director primacy is

events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a very rare possibility, but also because you do not know what else to do. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them."). *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1796; Geoffrey P. Miller, *Norms and Interests*, 32 HOFSTRA L. REV. 637, 641 (2003); Mitchell, *Trust*, *supra* note 23, at 191; Lynn A. Stout, *The Investor Confidence Game*, 68 BROOK. L. REV. 407, 410-15 (2002) [hereinafter Stout, *Investor Confidence*].

52. *Cf.* Elhauge, *supra* note 35, at 740 ("internalized moral norms"); Stout, *Proper Motives*, *supra* note 12, at 23 ("internal gyroscope").

53. *Cf.* Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 465-66 (2007); Rock & Wachter, *supra* note 9, at 1608; Stout, *Proper Motives*, *supra* note 12, at 9, 23. *See also* Michael J. Meurer, *Law, Economics, and the Theory of the Firm*, 52 BUFF. L. REV. 727, 740 (2004) (stating with regard to the problem of unforeseeable contingencies in transaction-cost-theory 'contracting' that "this begs the questions of how a firm gets managers to be pure profit maximizers").

54. To complicate things further, much of what happens in the corporate boardroom (and can be hoped to happen in the boardroom) depends on the particular corporation and follows the (aspirational and prevailing) procedures, standards and practices for director behavior of such specific corporation; *see, e.g.*, Rock & Wachter, *supra* note 9, at 1608.

55. *Cf.* Mitchell, *Trust*, *supra* note 23, at 191 ("Why would anybody invest money in a corporation, an institution over which she has no control?"); Stout, *Proper Motives*, *supra* note 12, at 3; *id.* at 8 (asking why directors "seem to mostly live up to our trust"); *id.* at 9 ("Rational investors would never cede control of tens of trillions of dollars of assets to purely self-interested boards, given the tissue-paper thin protection offered by the rules of fiduciary duty, and the limits of social sanctions.").

56. *Cf.* Rock & Wachter, *supra* note 5, at 1643-44.

57. Or formulated differently, the question is not only "*[w]hy* do shareholders in public companies have so little power?" (Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 792 (2007) (emphasis added) [hereinafter

absolute and our theoretical models are all reliant on protolegal variables to explain general investor confidence *ex-ante-investment* despite the lack of director accountability *ex-post-investment*, then how can director primacy be understood and explained as a principled and, thus, just corporate governance structure in the first place? Or is director primacy not only absolute, but also without principle?

This Article provides a roadmap for purposes of answering this inquiry. Part II further describes the problem left unsolved to date—namely, that we currently use largely unexplained and, thus, unaccounted-for protolegal variables to explain and predict the decisionmaking behavior of corporate directors. Part III essays to explain why—conceptually and normatively—we appear to need, and thus develop, distributional, *ergo* macrotheoretical, models of the firm in the first place. Those models place the decisionmaking behavior of corporate directors in the larger context of our social polity.[58] They inevitably address the social benefits and costs of doing business in the corporate form[59] and the resultant questions of sociopolitical legitimacy and allocative and distributive justice of the corporate endeavor.[60] Parts IV and V

Stout, *Mythical Benefits*]), but why do shareholders in public companies have so little power *and still invest?* Why do investors who know that they have almost no power over their investment ex post (other than investment exit with a predictable loss of value) still confidently decide to invest without any ex ante bargained-for accountability in place? *Cf. id.* at 801 (pointing out an often overlooked fact of business life, namely that "investors are not forced to purchase shares in public corporations at gunpoint."); *id.* at 803 ("Is it possible that shareholders, like Ulysses, sometimes see advantage in 'tying their own hands' and ceding control over the corporation to directors largely insulated from their own influence?").

58. *Cf.* Henry Hansmann & Reinier Kraakman, *What is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 18 (2004); Mitchell, *Trust and Team*, *supra* note 50, at 870; Romano, *supra* note 1, at 924; Wallman, *Understanding*, *supra* note 10, at 809-10. *Contra* Ronald J. Gilson, *Separation and the Function of Corporation Law*, 2 BERKELEY BUS. L.J. 141, 147 (2005) ("The point is that markets encourage a management and governance structure that fits the corporation's business. Corporate law has nothing to add to the process.").

59. *See, e.g.*, Eisenberg, *supra* note 10, at 819, 824; Lee, *supra* note 10, at 538-39; Benedict Sheehy, *Corporations and Social Costs: The Wal-Mart Case Study*, 24 J.L. & COM. 1, 3, 17-20 (2004); Randall S. Thomas, *What is Corporate Law's Place in Promoting Societal Welfare?: An Essay in Honor of Professor William Klein*, 2 BERKELEY BUS. L.J. 135, 135 (2005).

60. *Cf.* Allen, *supra* note 9, at 1396-97; Millon, *supra* note 3, at 201-02; Edward Rock & Michael Wachter, *Meeting By Signals, Playing By Norms: Complementary Accounts of Nonlegal Cooperation in Institutions*, 36 U. RICH. L. REV. 423, 434 (2002);

survey and evaluate the more recent interest of the legal academia in the co-existence of (corporate) law and norms and the latter's impact on (and, maybe, complete control over) the former—the so-called "law and norms" literature.[61]

II. THE PROBLEM LEFT UNSOLVED: PROTOLEGAL VARIABLES

The research on corporate governance can be described as the gradual unfolding of the formerly hidden inner workings of a "black box" (in the sense of observable inputs, "hidden inner magic," observable outputs, and end of story).[62] Originally, very little academic attention was given to how corporations work on the inside, as corporate law itself was deemed uninspiring and lacking any true intellectual vigor.[63]

Rock & Wachter, *supra* note 9, at 1608.

61. *See, e.g.*, Robert D. Cooter & Melvin A. Eisenberg, *Fairness, Character, and Efficiency in Firms*, 149 U. PA. L. REV. 1717, 1717 (2001); Jones, *supra* note 15, at 121-24; Kahan, *supra* note 5, at 1870; Rock & Wachter, *supra* note 5, at 1621-22.

62. *See e.g.*, Allen, *supra* note 9, at 1398 (stating that, until recently, "the internal operation of corporate actors was no more interesting than the internal operation of human actors"); Meurer, *supra* note 53, at 729-30 (describing the original theories of Coase and Williamson as treating the firm "like a black box in which authority avoids transaction costs" and concluding that "[m]odern research on the firm opens up the black box and gives a better account of how firms are organized and the costs and benefits of firm governance"); O'Kelley, *The Entrepreneur*, *supra* note 3, at 757 (stating the firm is a "black box" in classical and neoclassical perfect competition theory); Walter W. Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RES. ORGAN. BEHAV. 295, 296 (1990) (describing the paradigm shift developed by Ronald Coase in 1937, conceiving of the firm as a governing structure, thus, "breaking with orthodox accounts of the firm as a 'black box' production function"); Christopher D. Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 8 (1980) (claiming regulatory enforcement intervention imposes direct and selective constraints on how investors and managers work out various internal firm relationships and the "black box" prerogative of the enterprise's interior is, thus, overcome).

63. *See, e.g.*, Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962) (famously conveying his sentiment of listlessness by stating that corporate law, "as a field of intellectual effort, is dead in the United States" and that nothing was left "but our great empty corporation statutes—towering skyscrapers of rusted girders, internally welded together and containing nothing but wind"); Lyman P.Q. Johnson, *Faith and Faithfulness in Corporate Theory*, 56 CATH. U. L. REV. 1, 1 (2006) (stating that corporate law scholarship was "[v]irtually nontheoretical until the mid 1970s"); O'Kelley, *The Entrepreneur*, *supra* note 3, at 763 (stating that after the Berle-Means era, "corporation law scholarship, if not 'dead,' was

Once Berle and Means, however, had formulated their separation paradigm, corporate law became gradually stuck with answering the two deceptively simple, but fundamentally elusive questions of the former "black box" of corporate governance—namely: "who control(s)?" and "whose interest(s) control(s)?"[64]

My answers to these two core questions of corporate governance, as developed in my *absolute director primacy model*,[65] are as follows: monitoring[66] and bonding[67] of corporate directors by other firm participants, at its very best, incompletely protects the participants' respective firm-specific investments.[68] Not only do directors have a residual set of options available to exercise their decisionmaking authority in an opportunistic manner,[69] but, as a matter of corporate law, they have a complete set of nonreviewable options available pursuant to their absolute, *sui generis* decisionmaking authority. The core agency (cost) problem of corporate governance[70] is not simply residual, it is center-stage, abso-

certainly viewed as an intellectual backwater"); Romano, *supra* note 1, at 923 (confirming that "[u]ntil recently, corporate law has been an uninspiring field for research even to some of its most astute students").

64. *See* BAINBRIDGE, *supra* note 1, at 10, 21; CLARK, *supra* note 22, at 690; Bainbridge, *Primacy*, *supra* note 12, at 549-50; Dooley, *supra* note 6, at 466; Reich-Graefe, *supra* note 10.

65. Reich-Graefe, *supra* note 10.

66. Blair & Stout, *Team Production*, *supra* note 5, at 743; James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 L. & CONTEMP. PROBS. 83, 83-84 (1985); Michael B. Dorff, *Does One Hand Wash the Other? Testing the Managerial Power and Optimal Contracting Theories of Executive Compensation*, 30 J. CORP. L. 255, 257 (2005); Elhauge, *supra* note 35, at 739 ("[A] legal duty to maximize profits is too *hard* to monitor."); Pinto, *supra* note 3, at 260.

67. Stout, *Proper Motives*, *supra* note 12, at 4 ("Closer analysis suggests . . . that . . . bonding is mostly illusory.").

68. *See, e.g.*, Blair & Stout, *Trustworthiness*, *supra* note 5, at 1807-08; Cooter & Eisenberg, *supra* note 61, at 1719-20; Ribstein, *supra* note 31, at 1434; Rock & Wachter, *supra* note 9, at 1614.

69. *Cf.* Rock & Wachter, *supra* note 9, at 1614; Richter, *supra* note 5, at 174-75 ("Under Knightian uncertainty, it is impossible to write a complete contract that details all possible future contingencies, even if transaction costs are zero. Therefore, contracts unavoidably contain loopholes and the lock-in of the parties may invite opportunistic behavior by the other side because the parties may be unable to verify their case to a third party (e.g. a court) due to information costs (a special kind of transaction costs).") (footnote omitted).

70. *See*, *e.g.* BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 75 ("Much of corpo-

lute and systemic under the *absolute director primacy model*. Corporate directors are given vast latitude and incentive to misbehave by shirking on their performance.[71] As a result, when the opportunity to exercise nonreviewable options arises, director behavior is absolutely unpredictable. We no longer operate on a straightforward dyadic motivational plane: we can no longer assume that directors act either in their own selfish economic interest[72] or in the economic interest of a clearly defined group of firm participants (for example, shareholders).[73] Directors can exercise their control over the corporate venture in any manner. Thus, there is complete, not residual, resource scarcity for investors.[74] Once we admit that we are operating in a world where legal constraints on the decisional substance of genuinely disinterested director behavior are entirely lacking (other than, perhaps, at the outermost limits of where rationality ventures into irrationality), it becomes clear that investors face complete scarcity of information[75]—both *ex-ante* and *ex-post*—over which decisional motives and incentives will control (or have controlled) directorial decisionmaking in a particular context.[76]

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rate law is best understood as a mechanism for containing . . . agency costs."); Blair & Stout, *Team Production*, *supra* note 5, at 743 (describing the agency cost problem of monitoring managers and motivating them to act as faithful agents as "the central economic problem to be faced in a public corporation" for those following the principal-agent model of the firm); Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 33 (2004); Shleifer & Vishny, *supra* note 4, at 740-48 (discussing the agency problem as the central problem of corporate governance).

71. Johnson, *supra* note 63, at 4-5; Reich-Graefe, *supra* note 10.

72. Stout, *Investor Confidence*, *supra* note 51, at 412.

73. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 3, at 76; RICHARD W. HAMILTON & RICHARD A. BOOTH, CORPORATIONS 505, 506 (5th ed. 2006); Blair & Stout, *A Team Production*, *supra* note 15, at 290; Stout, *Mythical Benefits*, *supra* note 57, at 804.

74. Rock & Wachter, *supra* note 9, at 1614.

75. *Id*.

76. This is the only substance of the so-called "waste doctrine" or "outer-limits test" employed by courts in order to probe for alleged due care violations with regard to the substance (rather than the process) of directorial behavior. *See*, *e.g.*, Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (en banc) (stating that the outer limits of directorial behavior "are confined to unconscionable cases where directors irrationally squander or give away corporate assets"); Glazer v. Zapata Corp., 658 A.2d 176, 183 (Del. Ch. 1993) (describing the legal test for corporate waste as "severe" and explaining the test as follows: "Directors are guilty of corporate waste, only when they authorize an exchange that is so one sided that no business person of ordinary, sound judgment could

The relationship between directors and other firm participants is, therefore, characterized by intentionally incomplete contracting.[77] Unlike all other models of the firm developed to date, the *absolute director primacy model* is the only model that posits that the incompleteness overwhelmingly predominates (and intentionally so); that the gaps, the missing parts, significantly outweigh and outnumber those parts of the corporate nexus that we can currently explain and account for in our models. Accordingly, the role and purpose of our current law of corporate governance cannot focus on legal enforcement of what is not there (or is only aspired to be there in directorial behavior *sua sponte*).[78] Simply too much substance (which results in observable directorial behavioral compliance and board integrity) is not there unless by way of a complex process of autopoiesis.[79] We can observe and explain why it is

conclude that the corporation has received adequate consideration. If reasonable, informed minds might disagree on the question, then in order to preserve the wide domain over which knowledgeable business judgment may safely act, a reviewing court will not attempt to itself evaluate the wisdom of the bargain or the adequacy of the consideration."); Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997) (explaining that directors might be held liable under the waste test in cases where the benefit to the corporation is "so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."). *Cf.* Dooley, *supra* note 6, at 479-80 (describing possible board decisions that "even viewed *ex ante*, seem so degraded from ordinary prudential standards as to seem at least 'half-crazy,' if not full-blown demented"); David Rosenberg, *Galactic Stupidity and the Business Judgment Rule*, 32 J. CORP. L. 301, 304 (2007); *id.* at 314 ("There must be a point at which a court will look at a decision that appears to be free from any hint of disloyalty and review it simply because of its utter galactic stupidity.") (footnote omitted).

77. *Cf.* Rock & Wachter, *supra* note 9, at 1614. Contractarian theories of the firm use the words 'contract' and 'contractual' in a broader sense to include non-consensual rational economic relationships that are premised on implicit, self-governing arrangements between firm participants which do not result from express bargaining and, thus, do not constitute actual contracts in the legal sense. *See, e.g.*, HAMILTON & BOOTH, *supra* note 73, at 330; Eisenberg, *supra* note 10, at 822-23; Rock & Wachter, *supra* note 5, at 1650, 1688; Rock & Wachter, *supra* note 9, at 1613. Accordingly, within this Article, I indicate such broader contractarian use of the words 'contract' and 'contractual' by enclosing them in single quotation marks.

78. The current legal literature on incomplete contracting demonstrates that the law only responds to contractual incompleteness by invoking reliance, forbearance and a narrow interpretation of the existing (though incomplete) substance of the contract. In other words, contractual gap-filling by courts proceeds in a very measured and reluctant fashion. *See, e.g.*, Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 271-72 (1992).

79. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 614 ("Ideally, and in its original design,

not there when it is not there. However, we cannot explain how it got there when it is there. We want (and, logically, need) discretion of corporate directors.[80] Moreover, as I argue under the *absolute director primacy model*, directorial discretion is absolute and nonreviewable.[81] Thus, one may argue that the current state of our corporate governance system is characterized not only by intentional incompleteness, but also by an intentional and purposeful refusal to provide any legal mechanism of accountability to fill those canyon-wide 'contractual' gaps created by absolute, nonreviewable directorial discretion. Such refusal, at the same time, also constitutes a decided rejection by corporate law to provide model-immanent meaning to macrotheoretical, allocative and distributive concerns entering the realm of corporate governance. Thus, it evidences a decided rejection to provide any inner legitimacy or intelligibility within the domain of either the letter or the spirit of corporate law.

So far then, my answers to the two fundamental questions of corporate law are as follows: First, we know who controls—namely, directors, with absolute primacy. However, second, when we ask whose interest(s) control(s), we are faced with both a complete *ex-ante* indeterminability of director behavior and, thus, a complete *ex-ante* unpredictability of director behavior within the *absolute director primacy model*. Those answers may simply suggest the weakness of my model. However, I believe that they accurately reflect (at least, with regard to directorial decisionmaking power and its consequences on controlling interests, if any) both corporate and corporate law reality.

As a consequence of these (provisionally incomplete) answers to the two fundamental questions of corporate governance, I need to look somewhere outside the realm of corporate law for something that corporate law not only presupposes but that is of critical use to corporate law (as well as the theoretical models of the firm) in order to allow for the

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fiduciary obligation is self-enforcing.").

80. *See*, *e.g.*, ARROW, *supra* note 28, at 78 ("If every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem."); BAINBRIDGE, *supra* note 1, at 11; Bainbridge, *Primacy*, *supra* note 12, at 573 ("Neither discretion nor accountability can be ignored because both promote values essential to the survival of business organizations. Unfortunately, they are ultimately antithetical: one cannot have more of one without also having less of the other. At some point, directors cannot be made more accountable without undermining their discretionary authority.") (footnote omitted); Dooley, *supra* note 6, at 470.

81. Reich-Graefe, *supra* note 10.

simple fact that firm investments can be made confidently *ex-ante*.[82] From all we can tell, these investments are made—daily and literally millions of times over,[83] and with a good measure of predictive accuracy. Therefore, something currently left unexplained must allow for investor confidence and economic efficiency *ex-ante-investment*.[84] Something exists that makes absolute director primacy principled, so that firm participants willingly make firm-specific investments despite the lack of director accountability *ex-post-investment*.

This "something" I call "protolegal variables." With this admittedly open-ended and diffuse[85] label, I try to distill into one category all those socio-contextual,[86] behavior-oriented and reciprocal[87] normative implications and foundations of interpersonal cooperation[88] which are based on expectations and counter-expectations.[89] I will explain them in

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82. *Cf.* Dorff, *supra* note 66, at 257 ("To induce investors to buy stock ex ante, corporate governance law must be designed to give confidence that managers will seldom cheat and that when they do cheat they will generally be detected and punished.").

83. For example, the average daily trading volume on the New York Stock Exchange for NYSE-listed companies in 2009 totaled 7,982,926 trading transactions *per diem*, comprising an average of 2,179,775,581 shares traded for a total average consideration of $46,670,638,331. *Facts & Figures: Interactive Viewer*, NYSE, http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=3002&category=3. *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1737.

84. *Cf.* Bainbridge, *Competing Concepts*, *supra* note 13, at 80; William A. Klein, *Criteria for Good Laws of Business Associations*, 2 BERKELEY BUS. L.J. 13, 15 (2005).

85. *See* Oliver E. Williamson, *Calculativeness, Trust and Economic Organization*, 36 J.L. & ECON. 453, 469 (1993) [hereinafter Williamson, *Calculativeness*] ("If calculative relations are best described in calculative terms, then diffuse terms, of which trust is one, that have mixed meanings should be avoided when possible."). *Cf.* Diego Gambetta, *Can We Trust Trust?*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 213, 213-14 (Diego Gambetta ed., 1988) ("irritating rhetorical flabbiness"). *See also* Richard A. Epstein, *Contract and Trust in Corporate Law: The Case of Corporate Opportunity*, 21 DEL. J. CORP. L. 5, 10 (1996) ("At some point concrete rules will have to give way, or at least share the stage, with other rules of a more general and diffuse nature.").

86. *See* Stout, *Proper Motives*, *supra* note 12, at 13.

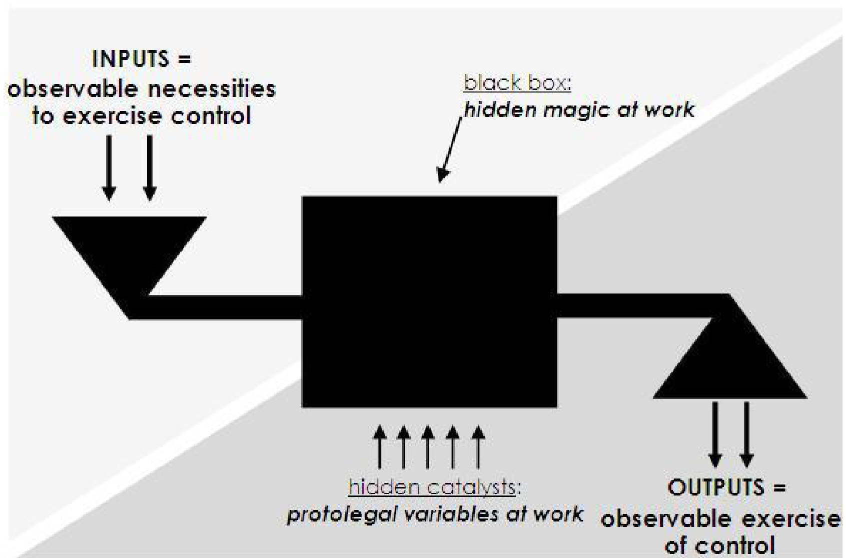
87. *Cf.* Fehr & Gächter, *supra* note 49, at 159.

88. It is interesting to note in this context that economists describe the various forms of opportunism and other agency costs related to the firm as "*moral* hazards." *See, e.g.*, Blair & Stout, *Team Production*, *supra* note 5, at 748; Meurer, *supra* note 53, at 733-34.

89. LUHMANN, LOVE, *supra* note 51; LUHMANN, RISK, *supra* note 51; LUHMANN, SOCIAL SYSTEMS, *supra* note 51; LUHMANN, TRUST, *supra* note 51; Luhmann, *Familiarity*, *supra* note 51, at 97 ("You cannot live without forming expectations with respect to

Part IV and V of this Article in more detail. However, before I do, I must explain how and where in the corporate governance process they come into play. Figure 1 illustrates this process schematically.

Figure 1
The Decisionmaking Black Box



Almost eighty years after Adolf Berle and Gardiner Means' seminal study,[90] I posit that we are still looking at the same basic "black box" I mentioned above[91] with its still hidden inner magic. As corporate theorists, we certainly have made progress by determining the designated function of the black box within corporate governance—namely, to generate certain control outputs from a wide range of factual inputs that provide (at least, incomplete empirical) answers as to "who control(s)?" and "whose interest(s) control(s)?" It is the core functionality of the

contingent events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a very rare possibility, but also because you do not know what else to do. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them."). *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1796; Miller, *supra* note 51, at 641; Mitchell, *Trust*, *supra* note 23, at 191; Stout, *Investor Confidence*, *supra* note 51, at 410-15.

90. BERLE, JR. & MEANS, *supra* note 2.

91. *See supra* note 62 and accompanying text.

black box to generate those output determinations in every new context of a given corporate reality necessitating an exercise of corporate control. However, we have not yet deciphered and explained the precise inner workings of the corporate decisionmaking black box so that we could arrive at any genuine measure of predictive accuracy for those particularized output determinations. I posit that we still have no well-developed idea—at least, not within the framework of corporate law—as to how corporate directors will select from a complete, virtually unlimited range of options[92] and, in particular, how they are incentivized to repeatedly select "properly" and to "do the right thing."[93] In other words, inputs and outputs are observable. The rest, in the middle—which, of course, is the main interest—is not observable. The magic is still hidden. However, my best guess is that we can begin to explain and uncover the magic by focusing on model-critical protolegal variables. They may be the hidden catalysts that create intuitive *ex-ante* determinability for firm participants and that make director behavior sufficiently predictable for firm participants to invest and, thus, for the wealth creation exercise that is the corporate form at work to exist.[94]

To begin to understand why the middle is so difficult to explain, why we still have no well-developed idea as to how corporate directors act the way they act (which is usually in a non-opportunistic manner) and why they act in such a manner even without any legal constraints as part of the motivational picture, one inevitably ends up focusing on macrotheoretical models of the firm. These, by definition, struggle with the firm not only as a non-market, hierarchical structure of wealth creation, but predominantly with its overall place in society and with the eternal macro-question of corporate law—namely, whether and to what extent the corporate entity as an institution of private property and private-party ordering in the means of economic production and wealth maximization should be subordinated to the legitimate claims of the larger society that inextricably embeds its wealth maximization exercise. This, in turn,

92. *Cf.* Mitchell, *Trust*, *supra* note 23.

93. *Cf.* Grossman, *supra* note 53, at 465-66; Rock & Wachter, *supra* note 9, at 1608; Stout, *Proper Motives*, *supra* note 12, at 9. *See also* Meurer, *supra* note 53, at 740 (stating with regard to the problem of unforeseeable contingencies in transaction-cost-theory 'contracting' that "this begs the questions of how a firm gets managers to be pure profit maximizers").

94. Note again that *protolegal* variables may turn out to be "observable, but not verifiable." *Cf.* Hart, *Norms and Theory*, *supra* note 38, at 1702; Rock & Wachter, *supra* note 9, at 1617. Thus, the magic may, indeed, remain invisible to our eyes.

more thoroughly explains why we develop macrotheoretical models of the firm in the first place and why this macrotheorectical realm is not only of theoretical, but of practical relevance for directorial behavior characterized by absolute, unfettered decisionmaking power and discretion.

III. WHY MACROTHEORETICAL MODELS OF THE FIRM?

Macrotheoretical models of the firm[95] are less concerned with the inner workings of the firm (*i.e.*, its internal cohesion, adaptability and survival as a generator and maximizer of productive output and economic wealth).[96] Instead, they focus on the firm's characteristics and impacts as (i) a social institution (*i.e.*, a public good),[97] and (ii) a generator of externalities, both positive (*i.e.*, social benefits) and negative (*i.e.*, social costs).[98] These models exist because no corporation is truly an island of economic activity,[99] rather, it is inextricably embedded in the larger context of our societal polity.[100] Business corporations not only create and maximize wealth (when they are successful), they also distribute wealth[101]—by necessity and simultaneously. Every instance of

95. As opposed to "microtheoretical" models of the firm; *see supra* note 9.

96. *Cf.* Allen, *supra* note 9, at 1396; Millon, *supra* note 3, at 201-02; Rock & Wachter, *supra* note 9, at 1608.

97. *Cf.* BERLE, JR. & MEANS, *supra* note 2, at 352-53; Mitchell, *Trust and Team*, *supra* note 50, at 870; Blair & Stout, *Team Production*, *supra* note 5, at 748.

98. *Cf.* Sheehy, *supra* note 59, at 17; Thomas, *supra* note 59, at 135.

99. *Cf.* DENNIS H. ROBERTSON, THE CONTROL OF INDUSTRY 84 (1923) (stating that firms are "islands of conscious power in this ocean of unconscious co-operation [namely, the market] like lumps of butter coagulating in a pail of buttermilk"); George B. Richardson, *The Organisation of Industry*, 82 Econ. J. 883, 883 (1972) (describing firms in general as "islands of planned co-ordination in a sea of market relations"). *See also* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 393 (1937) ("These, then, are the reasons why organisations such as firms exist in a specialised exchange economy in which it is generally assumed that the distribution of resources is 'organised' by the price mechanism. A firm, therefore, consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur."); Powell, *supra* note 62, at 297; Rock & Wachter, *supra* note 5, at 1621.

100. Cf. Allen, *supra* note 12, 261, 264-65; Romano, *supra* note 1, at 924. *See also* John Donne, *Meditation XVII*, *in* DEVOTIONS UPON EMERGENT OCCASIONS 107, 108 (1624) ("No man is an island, entire of itself; every man is a piece of the continent, a part of the main.").

101. If business corporations are not successful, they, of course, destroy wealth and

wealth creation is, *ipso facto*, an instance of wealth distribution.[102] Corporate governance is the mere structure and mechanism of how those simultaneous instances of wealth creation and wealth distribution come about. In my view, all corporate decisionmaking by a board of directors logically reduces to (i) allocating existing wealth (productive resources) to the corporate endeavor, (ii) setting in motion the processes to create future wealth, and (iii) distributing such existing and future wealth among the whole range of firm participants (for example, as salaries to employees, dividends to stockholders, fees to suppliers, rebates to customers, taxes to local, state and federal authorities, etc.).[103] Corporate law is, thus, part of our system of justice and the rule of law. It is part of our system of private-sector ordering. Inevitably then, the (apparently, for some, "ugly"[104]) problem of socioeconomic and sociopolitical effi-

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distribute losses.

102. It is an often underestimated fact that every single board decision does both—allocating resources and distributing (future) benefits—simultaneously and often with allocative and distributive effects to multiple if not (at least, indirectly) all firm participants. What I mean here is that it is (too) often overlooked that, in the reality of the going-concern operation of the firm, there is no bifurcation whatsoever between the time the board acts hiring productive resources in order to create value and the time the board acts in order to distribute to the firm's value participants the cash flows resulting from the creation of value. Every time the board (or upper management) acts, including when it hires productive resources, it instantly allocates and distributes currently available as well as future cash flows among all firm participants. Thus, on a daily basis, future cash flows are pre-booked, pre-committed and pre-spent—when money comes in, some of it (or all of it, or even more than it) has already gone out. Accordingly, there is no factual distinction possible between wealth creation and wealth distribution, as both occur simultaneously once the corporation becomes a going concern.

103. *Cf. Grimes v. Donald*, 673 A.2d 1207, 1214-15 (Del. 1996) ("Likewise, business decisions are not an abdication of directorial authority merely because they limit a board's freedom of future action. A board which has decided to manufacture bricks has less freedom to decide to make bottles. In a world of scarcity, a decision to do one thing will commit a board to a certain course of action and make it costly and difficult (indeed, sometimes impossible) to change course and do another. This is an inevitable fact of life and is not an abdication of directorial duty.").

104. Ronald J. Gilson & Reinier Kraakman, *Clark's Treatise on Corporate Law: Filling Manning's Empty Towers*, 31 J. CORP. L. 599, 604 n.21 (2006). *See also* Milton Friedman, *The Social Responsibility of Business Is To Increase Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970 (arguing that "the doctrine of 'social responsibility' involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses"); Gilson, *supra* note 58, at 147 n.12 (pointing out that "markets encourage a management and governance structure that fits the corporation's business" and that

ciency, legitimacy and ultimate justice raises its head.[105]

A. JURISPRUDENTIAL MACRODICHOTOMIES

Unlike microtheoretical models of the firm, with their focus on the interdependent dichotomies between (i) discretion and accountability of corporate decisionmaking[106] and (ii) market value and societal value as controlling backstops for such decisionmaking,[107] macrotheoretical models of the firm are defined by the following three fundamental macrodichotomies:

- Aristotelean notions of rectification (corrective justice) and

"[c]orporate law has nothing to add to the process"). *See also* Douglas A. Kysar, *Sustainability, Distribution, and the Macroeconomic Analysis of Law*, 43 B.C. L. REV. 1, 22 (2001) ("More than one commentator has speculated that the disappearance of limits in macroeconomics serves as a theoretical expedient to avoid difficult questions of distribution."); Lee, *supra* note 10, at 575 ("The terms 'morality' and 'justice' may raise red flags for readers skeptical of deontology and inclined toward consequentialism.").

105. *See*, *e.g.*, Hansmann & Kraakman, *supra* note 58, at 18 ("As a normative matter, the overall objective of corporate law—as any branch of law—is presumably to serve the interest of society as a whole. More particularly, the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers without undue sacrifice—and, if possible, with benefit—to third parties such as local communities and beneficiaries or the natural environment. That is what economists would characterize as the pursuit of overall social efficiency."); Mitchell, *Trust and Team*, *supra* note 50, at 870 (describing the understanding of corporate organization in terms of team production not only as a "tale […] of economics alone" but also as "to conceive of the corporation as a political institution" and "as a social institution"); Pinto, *supra* note 3, at 257 n.2 ("Because of the importance of publicly traded corporation in society, there are significant issues over the focus of corporate governance, how power should be allocated within the corporation and the role of law and non-legal mechanisms in protecting investors and other stakeholders and allowing those who manage to effectively function."); Wallman, *Understanding*, *supra* note 10, at 809-10 (concluding that corporate governance must be aimed at maximizing "societal wealth over the long term").

106. See, e.g., Bainbridge, *Abstention Doctrine*, *supra* note 6, at 84; Blair & Stout, *Team Production*, *supra* note 5, at 743; Ibrahim, *supra* note 6, at 947-48; Mitchell, *Trust*, *supra* note 23, at 188-89; Pinto, *supra* note 3, at 266; Ribstein, *supra* note 25, at 198; Shleifer & Vishny, *supra* note 4, at 740-48.

107. *See*, *e.g.*, Gilson, *supra* note 58, at 143 (stating that "the criteria for good corporate law are limited to a single overriding goal: facilitating the maximization of shareholder wealth"). *See also* Gilson & Kraakman, *supra* note 104, at 599 (describing as a critical fact for the intellectual vigor of corporate law that "all of the interesting and challenging issues involve the resolution of conflicts between corporate participants").

fairness (distributive justice);[108]

- market liberalism (private liberty) and utilitarianism (social utility);[109] and
- the dialectics between the private/internal/market and the public/external/regulatory spheres of institutional power over the governance of the corporation (market and polity).[110]

Arguably, these macrodichotomies shape both the substance and the objectives of corporate law (as they also shape the substance and objectives of all other fields of law that we consider to be 'private law'). Each of them is replicated, *en miniature*, in the interdependence between the two microdichotomies of corporate governance—namely, (i) the fundamental agency problem of managerial primacy (the allocation of control with, and the resultant discretion of, corporate decisionmakers)[111] and shareholder/stakeholder primacy (the allocation of controlling property and/or contract rights with, and the resultant accountability to, specific firm participants),[112] and (ii) shareholder wealth (maximum market value) and stakeholder welfare (maximum societal value).[113] Descriptively, these three macrodichotomies relate to each other as set forth in Figure 2.

108. *See, e.g.*, Gregory C. Keating, *Distributive and Corrective Justice in the Tort Law of Accidents*, 74 S. CAL. L. REV. 193, 194-95 (2000); Ernest J. Weinrib, *Corrective Justice in a Nutshell*, 52 U. TORONTO L.J. 349, 349 (2002) [hereinafter Weinrib, *Corrective Justice*]; Ernest J. Weinrib, *Liberty, Community, and Corrective Justice*, 1 CAN. J. L. & JURISPRUDENCE 3, 4-5 (1988); Richard W. Wright, *The Principles of Justice*, 75 NOTRE DAME L. REV. 1859, 1868, 1890-92 (2000).

109. *See, e.g.*, Allen, *supra* note 9, at 1396; Romano, *supra* note 1, at 926.

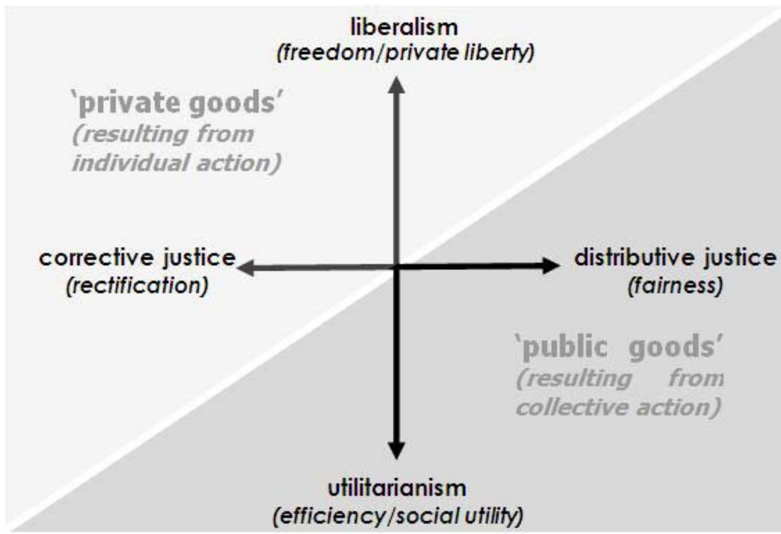
110. *See, e.g.*, Bainbridge, *Primacy*, *supra* note 12, at 549; Bratton, *supra* note 3, at 202; Richter, *supra* note 5, at 177 (describing Douglass North's concept of new institutional economics of history as aiming "at a general theory of the interaction between polity and economy").

111. *See, e.g.*, Blair & Stout, *Team Production*, *supra* note 5, at 743; Shleifer & Vishny, *supra* note 4, at 740-48.

112. *See, e.g.*, Gilson, *supra* note 58, at 143 (stating that "the criteria for good corporate law are limited to a single overriding goal: facilitating the maximization of shareholder wealth"); Hansmann & Kraakman, *supra* note 58, at 18 ("As a normative matter, the overall objective of corporate law—as any branch of law—is presumably to serve the interest of society as a whole.").

113. *Cf.* Allen, *supra* note 12, at 264-65; Fisch, *supra* note 10, at 639-40.

Figure 2
Plotting Jurisprudential Macrodichotomies



First, the firm can be seen as merely a result of private-party initiative and market competition. Accordingly, corporate law, as the enabling framework[114] for such private-party initiative and its participation in the marketplace, is a means to support a free-enterprise system where private parties should be at liberty to order their economic affairs as they see fit and without any regulatory intervention.[115] Collectively, all such incidents of private-party contractarian and/or transactional ordering combine to create—at least, in theory—Adam Smith's "invisible hand of the market."[116] In other words, market forces control.

This jurisprudential source of liberalism (its battle cry is freedom),[117] however, immediately needs to be juxtaposed with utilitarianism (the battle cry of which is efficiency).[118] Under utilitarianism, hie-

114. Allen, *supra* note 9, at 1400; Rock & Wachter, *supra* note 9, at 1608, 1617.

115. *Cf.* Allen, *supra* note 9, at 1396.

116. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 3 (1776) (Cannan ed. 1904), *available at* http://www.econlib.org/library/Smith/smWN13.html. *See* Rock & Wachter, *supra* note 5, at 1697.

117. Or human liberty in order to fend off the great evil of an oppressive, leviathan state. *See, e.g.*, Allen, *supra* note 9, at 1396.

118. *See, e.g.*, Wright, *supra* note 108, at 1868-71. *See also* Lawrence E. Mitchell,

rarchical forces control. Going back to Jeremy Bentham's definition of social utility as the principle of achieving the greatest possible happiness for the greatest possible number of people,[119] the corporate entity can also be subjected to general welfare concerns (*i.e.*, it can be regarded as a vehicle to foster the common good).[120] The problem of social utility of corporations is at the core of one of the three standard agency (cost) problems created by the corporate entity—namely, the interest conflicts between firm participants and outside parties.[121] Since Ronald Coase's famous explanation of the nature of firms in 1937 (as further elaborated by Oliver Williamson in his "markets and hierarchies" research program[122]),[123] we know that the corporate structuration must be eternally

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Vulnerability and Efficiency (of What?), 2 BERKELEY BUS. L.J. 153, 153-54, 159 (2005) ("The obvious candidate to serve as a metric of good corporate law is the efficient production of goods and services.").

119. JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION 9 (1780) (Pickering 1823). *See also* Wright, *supra* note 108, at 1868.

120. *Cf.* Hansmann & Kraakman, *supra* note 58 ("As a normative matter, the overall objective of corporate law—as any branch of law—is presumably to serve the interest of society as a whole."); Thomas, *supra* note 59, at 135 ("It strikes me that the overall goal of good corporate law should be to assist private parties to create wealth for themselves and the economy in a manner that does not inflict uncompensated negative externalities upon third parties.").

121. *See* Hansmann & Kraakman, *supra* note 5, at 22. The other two standard agency (cost) problems created by the corporate entity are between managers and investors (as discussed *supra*) and between controlling shareholders and minority shareholders. *Id.*

122. *See*, *e.g.*, OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975); Oliver E. Williamson, *The Logic of Economic Organization*, 4 J. L. ECON. & ORG. 65, 88 (1988) (arguing the existence of "three generic forms of governance – market, hybrid, and hierarchy"). *See also* Bernard Baudry & David Gindis, *The V-Network Form: Economic Organization and the Theory of the Firm* 1 (October 10, 2005), *available at* http://ssrn.com/abstract=795244; Powell, *supra* note 62, at 297. *See also* Meurer, *supra* note 53, at 729-30; Rock & Wachter, *supra* note 5, at 1631.

123. Coase, *supra* note 99, at 386, 388, 393 (asking "in view of the fact that it is usually argued that coordination will be done by the price mechanism, why is such organization necessary?" and then explaining that "[the] firm …consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur."). *See* COX & HAZEN, *supra* note 3, at 40; Allen, *supra* note 9, at 1398; Dooley, *supra* note 6, at 464; Mark Granovetter, *Business Groups*, *in* THE HANDBOOK OF ECONOMIC SOCIOLOGY 454, 454 (Neil J. Smelser & Richard Swedberg eds., 2000); Meurer, *supra* note 53, at 737; Powell, *supra* note 62, at 296-97; Rock & Wachter, *supra* note 5, at 1621. *See also* Sanford J. Grossman & Oliver D. Hart, *The*

stuck in this first macrodichotomy between market/freedom and hierarchy/efficiency. The corporation shelters private-party entrepreneurial activity from market forces and higher transaction costs by providing an efficient vehicle for pooling investments and subjecting those to a central command-and-control structure.[124]

A second macrodichotomy exists between the Aristotelean notions of corrective justice (its battle cry is rectification)[125] and concerns of distributive justice (the battle cry of which is fairness).[126] In *Book V* of his *Nicomachean Ethics*,[127] Aristotle formulated these two concepts of justice that remain central to contemporary theories of private law.[128] Corrective (or commutative[129] or interactive[130]) justice focuses on bipolar relations and correlativity.[131] Fiduciary duties owed by directors to the corporation provide an example of such bipolar relations within corporate governance. Fiduciary duties are seen as delictual obligations (*i.e.*,

Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration, 94 J. POL. ECON. 691, 692 (1986) (differentiating between specific rights and residual rights in order to explain firm boundaries); Oliver D. Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119, 1119 (1990) (setting forth a framework for addressing the question of "when transactions should be carried out within the firm and when through the market").

124. *See also* Bainbridge, *Competing Concepts*, *supra* note 13, at 81; Bainbridge, *Primacy*, *supra* note 12, at 555; O'Kelley, *The Entrepreneur*, *supra* note 3, at 759; Rock & Wachter, *supra* note 9, at 1617. *Cf.* ERIC HOBSBAWM, THE AGE OF EXTREMES 103 (1994) (describing how intellectuals and policy makers early in the 20th century already observed that an economy dominated by huge corporations made nonsense of the term 'perfect competition').

125. Keating, *supra* note 108, at 195; Weinrib, *Corrective Justice*, *supra* note 108, at 350.

126. Or *equality* (which both are the same word in Greek). *See* Weinrib, *Corrective Justice*, *supra* note 108, at 349. *See also* Keating, *supra* note 108, at 200.

127. ARISTOTLE, NICOMACHEAN ETHICS, Book V, Chapters 2-4 (W. D. Ross trans., Clarendon Press, 1908) (384 B.C.E.) *available at* http://www.ilt.columbia.edu/publications/Projects/digitexts/aristotle/nicomachean_ethics/book05.html.

128. Weinrib, *Corrective Justice*, *supra* note 108, at 349.

129. Cees Maris, *A ≠ A: Or, Freaky Justice*, 31 CARDOZO L. REV. 1133, 1152-53 (2010).

130. Wright, *supra* note 108, at 1883.

131. Jules L. Coleman, *The Practice of Corrective Justice*, *in* PHILOSOPHICAL FOUNDATIONS OF TORT LAW 53, 66-67 (David G. Owen ed., 1995); Keating, *supra* note 108, at 197; Weinrib, *Corrective Justice*, *supra* note 108, at 351; Ernest J. Weinrib, *Correlativity, Personality, and the Emerging Consensus on Corrective Justice*, 2 THEORETICAL INQ. L. 107, 110, 117 (2001); Weinrib, *supra* note 108, at 5.

their breach resonates in tort, not in contract).[132] The basic idea is that parties to bipolar relations have an original, notional equality relative to their transactions/interactions with each other.[133] If one party breaches such state of equality, liability of that party is necessary to rectify the transactional/interactive injustice inflicted to the other party.[134] Thus, corrective justice is about the restoration of the parties' original equality relative to their transaction/interaction.[135]

Distributive justice applies to multipolar relations.[136] An example in corporate governance is the obligation of directors to act in the best interest of the corporation, which requires allocative and distributive decisions with regard to all productive factors involved in the corporation as a whole. Principles of distributive justice are normative principles designed to allocate goods in limited supply relative to their demand by various constituents.[137] The main concern is fair allocation and distribution of resources and wealth.[138] In Aristotelean terms, each party shall receive according to her due.[139] Thus, the relative merit of each party in a multipolar relationship (*i.e.*, their proportional equality) matters.[140] Principles of distributive justice are thought to operate independent of any individual interactions between the parties. The very nature of the corporation as a vehicle to pool firm-specific investments from a wide range of firm participants is obviously multipolar. Therefore, distributive justice concerns are immediately implicated. Nonetheless, the gist

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132. *See, e.g.*, ENEA v. Superior Court, 34 Cal. Rptr. 3d 513, 519 (Cal. Ct. App. 2005) (describing fiduciary duties as "delictual" duties "imposed by law" and that "their breach sounds in tort"); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 887. *But see, e.g.*, Alces, *supra* note 42, at 244 ("All fiduciary relationships are, at some level, contractual."); *id.* at 270-71 ("Even though all fiduciary relationships are contractual, not all contractual relationships are fiduciary.").

133. Weinrib, *Corrective Justice*, *supra* note 108, at 349.

134. *Id.*; Wright, *supra* note 108, at 1891.

135. *Cf.* Wright, *supra* note 108, at 1891.

136. Weinrib, *supra* note 131, at 117; Weinrib, *Corrective Justice*, *supra* note 108, at 351-52.

137. *Cf.* Keating, *supra* note 108, at 200; Wright, *supra* note 108, at 1890.

138. Weinrib, *Corrective Justice*, *supra* note 108, at 349; Weinrib, *supra* note 108, at 4; Wright, *supra* note 108, at 1890.

139. Weinrib, *Corrective Justice*, *supra* note 108, at 349; Maris, *supra* note 129, at 1152. Similarly, distributive justice requires that equal cases be treated equally and unequal cases be treated unequally. *See id.* at 1133-34, 1152.

140. Weinrib, *Corrective Justice*, *supra* note 108, at 349.

of corporate law dealing with the microtheoretical problems of the firm, namely the two fundamental questions of corporate governance discussed above, operates in paradigms of bipolar relations (*i.e.*, in paradigms of corrective justice). Only in the rare case of an unignorable third relation (*e.g.*, a hostile takeover predator) has corporate law been forced to explicitly acknowledge multipolarity and to deal (or, shall we say, struggle) with its fallout.[141]

Both macrodichotomies discussed so far combine into a third, overarching macrodichotomy that has been developed by two main representatives of new institutional economics ("NIE"): Oliver Williamson, on the one hand, who established the field of transaction cost economics ("TCE"), which may be viewed as a microeconomic study of markets and firms,[142] and Douglass North, on the other hand, who established the field of new institutional economics of history ("NIEH"), which may be viewed as a macroeconomic analysis of markets and firms.[143] TCE, in

141. *See*, *e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-56 (Del. 1985); Paramount Commc'ns, Inc. v. Time Inc. 571 A.2d 1140, 1143-44 (Del. 1989). *Compare* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985). In general, *see*, *e.g.*, Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1, 1-3 (2004); Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215, 2245-48 (1992); Lyman Johnson, *New Approaches to Corporate Law*, 50 WASH. & LEE L. REV. 1713, 1715-17 (1993); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1203-04 (2002).

142. *See*, *e.g.*, WILLIAMSON, ANTITRUST IMPLICATIONS, *supra* note 122; OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); Oliver E. Williamson, *Introduction* to THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 3 (Oliver E. Williamson & Sidney G. Winter eds., 1991); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979); Oliver E. Williamson, *Transaction Cost Economics Meets Posnerian Law and Economics*, 149 J. INST. & THEORETICAL ECON. 99 (1993); Oliver E. Williamson, *Transaction Cost Economics: The Precursors*, *in* REGULATION, DEREGULATION, REREGULATION: INSTITUTIONAL PERSPECTIVES (Claude Ménard & Michel Ghertman eds., 2009); Oliver E. Williamson, *Transaction Cost Economics and Organization Theory*, *in* ORGANIZATION THEORY: FROM CHESTER BARNARD TO THE PRESENT AND BEYOND (Oliver E. Williamson ed. 1995); Oliver E. Williamson, *Why Law, Economics, and Organization?*, *in* THE ORIGINS OF LAW AND ECONOMICS: ESSAYS BY THE FOUNDING FATHERS (Francesco Parisi & Charles K. Rowley eds., 2005). *See also* Allen, *supra* note 9, at 1399; Richter, *supra* note 5, at 174-75.

143. *See*, *e.g.*, LANCE E. DAVIS & DOUGLASS C. NORTH, INSTITUTIONAL CHANGE AND AMERICAN ECONOMIC GROWTH (1971); DOUGLASS C. NORTH, STRUCTURE AND CHANGE IN ECONOMIC HISTORY (1981); DOUGLASS C. NORTH, INSTITUTIONS,

the Williamsonian tradition, focuses on arrangements made essentially between two actors[144] and deals with the transfer or administration of what economists call "private goods."[145] Those goods (*e.g.*, a contract) are seen as the result of individual action.[146] TCE mainly ignores protolegal variables (*e.g.*, norms, customs, mores, or traditions) as unalterable givens since they are located at the top level of social analysis, namely the "social embeddedness level" at which institutions "change very slowly—on the order of centuries or millennia."[147] Contrastingly, NIEH concentrates on the "formal and informal institutional constraints which control the behavior of more than two actors."[148] Its focus is the provision or administration of what economists call "public goods."[149] Such goods (*e.g.*, a corporation) are the result of collective action.[150] NIEH explicitly accounts for protolegal variables since the "public good" is seen as "nothing more nor less than the comprehensive system of cognitive and moral beliefs called ideology."[151] Protolegal variables thus impact (if not control, as argued under the *absolute director primacy mod-*

INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (James Alt & Douglass C. North eds., 1990); DOUGLASS C. NORTH & ROBERT PAUL THOMAS, THE RISE OF THE WESTERN WORLD: A NEW ECONOMIC HISTORY (1973); Douglass C. North, *Government and the Cost of Exchange*, 44 J. ECON. HIST. 255 (1984); Douglass C. North, *Institutional Change and Economic Growth*, 31 J. ECON. HIST. 118 (1971); Douglass C. North, *Structure and Performance: The Task of Economic History*, 16 J. ECON. LITERATURE 963 (1978) [hereinafter North, *Structure and Performance*]; Douglass C. North & Robert Paul Thomas, *The Rise and Fall of the Manorial System: A Theoretical Model*, 31 J. ECON. HIST. 777 (1971). *See also* Richter, *supra* note 5, at 173-76.

144. Oliver E. Williamson, *The Evolving Science of Organization*, 149 J. INST. & THEORETICAL ECON. 36, 56 (1993) ("Transaction cost economics mainly works out a dyadic set-up.").

145. Richter, *supra* note 5, at 178.

146. *Id.*

147. Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LITERATURE 595, 596 (2000). The social embeddedness level, according to Williamson, includes informal institutions, customs, tradition, norms and religion. *Id.* at 596. *See also* Richter, *supra* note 5, at 178 ("norms, customs, mores, tradition and so forth").

148. Richter, *supra* note 5, at 178.

149. *Id. See also* Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1657 (1996); Lawrence E. Mitchell, *Understanding Norms*, 49 U. TORONTO L.J. 177, 198-99 (1999) [hereinafter Mitchell, *Norms*].

150. Richter, *supra* note 5, at 178.

151. North, *Structure and Performance, supra* note 143, at 973.

el) the provision and administration of public goods.

In the light of such macrodichotomy, it seems possible to say the corporation is both a private good (or the result of a concert of private goods—namely, "contracts") and a public good. However, given the necessary multitude of productive resources pooled within the firm, the more essential nature of a corporation appears to be multipolar, thus, as a public good.[152]

B. NEGATIVE EXTERNALITIES

Macrotheoretical models of the firm have another very simple factual *raison d'être*: every productive endeavor by humans—as strictly secondary producers—generates costs.[153] Indeed, from a holistic, planetary perspective, modern humans are a frivolity of nature.[154] All modern human activity is ultimately exogenous and constitutes a net loss of natural resources compared to the *ex-ante* state of human activity.[155] We consume enormous amounts of high-grade, low-entropy energy and resources extracted from the ecosphere in order to produce and maintain something (including the consumption of matter-energy in the fairly small amounts we inevitably need to constantly sustain and regenerate ourselves).[156] In total amounts, these exercises of human production and maintenance result in a smaller total amount of available low-entropy matter-energy than was available on this planet before its transformation and consumption for purposes of human production and maintenance.[157]

152. In this regard, the firm not only resembles a nexus of contractual or quasi-contractual arrangements linking rational firm participants but a social institution within which firm participants form cooperative relationships for purposes of production and value creation. *See, e.g.*, Mitchell, *Trust and Team*, *supra* note 50, at 870; Blair & Stout, *Team Production*, *supra* note 5, at 748.

153. *Cf.* Sheehy, *supra* note 59, at 17.

154. *Cf.* Kysar, *supra* note 104, at 14 ("[A]lthough animals do grow in size and species do evolve in complexity, in actuality their physical growth and adaptation exacts a higher cost in terms of pure matter-energy than their new forms represent.").

155. *Cf.* HERMAN E. DALY, BEYOND GROWTH: THE ECONOMICS OF SUSTAINABLE DEVELOPMENT 35 (1996) ("The macroeconomy is an open subsystem of the ecosystem and is totally dependent upon it, both as a source for inputs of low-entropy matter-energy and as a sink for outputs of high-entropy matter-energy."); Kysar, *supra* note 104, at 35; Sheehy, *supra* note 59, at 17 n.57.

156. *Cf.* Kysar, *supra* note 104, at 22.

157. *Cf.* Nicholas Georgescu-Roegen, *The Entropy Law and the Economic Problem*, *reprinted in* VALUING THE EARTH: ECONOMICS, ECOLOGY, ETHICS 75, 80 (Herman E.

At the same time, these exercises of human production and maintenance also result in high-entropy outputs that the ecosystem has to assume and regenerate. Thus, in terms of total amounts of energy and resources available, modern man's existence is always wasteful and, thus, never genuinely productive.[158] "Wealth/value" and "wealth/value creation" are therefore mere fictions fabricated by human beings.

Correspondingly, any perceived "wealth" we are generating in absolute terms is the result of destroying a much larger amount of natural capital. To make it look good (and to ignore that we consume and destroy the only natural capital available to us faster and more systematically than our natural capital has time and resources to regenerate and to continue maintaining us), the trick is to simply ignore and not account for the costs that are the necessary and principal ingredient in order to generate "wealth." Focusing on the "wealth" so produced, and simultaneously ignoring, or at least, downplaying, the associated costs of wealth production, results in a virtual, reality-denying net gain, rather than in the actual and very real total loss that modern human "wealth" creation inevitably generates.[159]

Thus, the inescapable problems of all modern human activity, including in the form of the corporate endeavor, are negative externalities

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Daly & Kenneth N. Townsend eds., 1993) (explaining that "the cost of any biological or economic enterprise is always greater than the product"); Kysar, *supra* note 104, at 25.

158. And we are starting to run on empty, i.e., to exceed the "carrying capacity" of the only ecosystem available to us. Kenneth E. Boulding, *The Economics of the Coming Spaceship Earth* (1966), *reprinted in* VALUING THE EARTH: ECONOMICS, ECOLOGY, ETHICS 297, 303 (Herman E. Daly & Kenneth N. Townsend eds., 1993) ("The closed economy of the future might similarly be called the 'spaceman' economy, in which the earth has become a single spaceship, without unlimited reservoirs of anything, either for extraction or for pollution, and in which, therefore, man must find his place in a cyclical ecological system which is capable of continuous reproduction of material form even though it cannot escape having inputs of energy."); Kysar, *supra* note 104, at 27 ("Ecological economists, however, believe that humanity has now moved to the 'spaceman economy' . . . , in which human productive capacity has outstripped the carrying capacity of the earth; that is, the binding constraint on material throughput is no longer our capacity to produce, but the earth's capacity to generate resource inputs and absorb waste outputs.") (footnote omitted).

159. *See* Kysar, *supra* note 104, at 29 ("Current national accounting measures produce a variety of results that would strike noneconomists as odd. . . . Social as well as ecological costs frequently appear as gains under GNP accounting."); Sheehy, *supra* note 59, at 17 n.57.

(*i.e.*, social costs).[160] As has been pointed out some time ago, "[o]ne of the most fateful errors of our age is the belief that 'the problem of production' has been solved."[161] Indeed, "[a]ll economic activity must necessarily involve a step, however small, toward the exhaustion of available energy."[162] Thus, "[i]nfinite growth in a finite environment is an obvious impossibility."[163]

Against this backdrop, shareholder wealth can no longer be equated with social welfare—nor can firm value any longer be equated with social value.[164] They are dichotomous. The simple reason for such dichotomy is that firm value is inevitably associated with social costs. Firms create perceived "value" to a large extent by externalizing the negative aspects of their value production exercises to outside factors (third parties, the environment, etc.).[165] The greater the concentration of economic power of a firm, in particular in the form of the modern Berle-

160. *See* Thomas, *supra* note 59, at 135 ("It strikes me that the overall goal of good corporate law should be to assist private parties to create wealth for themselves and the economy in a manner that does not inflict uncompensated negative externalities upon third parties."). The concept of externalities was introduced in economic discourse by Arthur Pigou in 1920. ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE 149-179 (1920) (discussing the concept of externalities in markets). *See also* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 28-29 (1960); Kysar, *supra* note 104, at 9; Sheehy, *supra* note 59, at 17 n.57. For a general discussion of the concept of externalities, *see*, *e.g.*, STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 77-109 (2004).

161. E.F. SCHUMACHER, SMALL IS BEAUTIFUL – ECONOMICS AS IF PEOPLE MATTERED 1 (1973) (Hartley & Marks 1999).

162. Kysar, *supra* note 104, at 15. *See also* Georgescu-Roegen, *supra* note 157, at 85 ("Every time we produce a Cadillac, we irrevocably destroy an amount of low entropy that could otherwise be used for producing a plow or a spade. In other words, every time we produce a Cadillac, we do it at the cost of decreasing the number of human lives in the future. Economic development through industrial abundance may be a blessing for us now and for those who will be able to enjoy it in the near future, but it is definitely against the interest of the human species as a whole, if its interest is to have a lifespan as long as it is compatible with its dowry of low entropy.").

163. SCHUMACHER, *supra* note 161, at 33. See also Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244 (1968) ("Therein is the tragedy. Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited. Ruin is the destination toward which all men rush, each pursing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all."). *Cf.* Kysar, *supra* note 104, at 22.

164. *Cf.* Allen, *supra* note 12, at 264-65; Fisch, *supra* note 10, at 639-40; Ribstein, *supra* note 31, at 1433-34.

165. Coase, *supra* note 160, at 1.

Means corporation, the larger the potential for negative externalities (*i.e.*, social costs).[166] Many of those externalities remain unaccounted for and, in particular, unreported.[167]

The three fundamental macrodichotomies discussed above, and the eternal problem of externalities, not only affect but define the acquired interest preferences of our libertarian, free-enterprise-oriented society,[168] and, thus, of our private law, corporate law, and law of corporate governance. Collectively, they can be defined as protolegal *per se*. In other words, we have reached the macrotheoretical core of directorial decisionmaking in the absence of any effective legal constraints under our American corporate law. This macrotheoretical core of protolegal concerns provides American corporate law with a principal range of ultimately dialectic jurisprudential foundations that insolubly remain in conflict. They therefore, must find their way, and somehow translate, into the individual moral compass of every human being, including, as is of interest here, the respective individual moral compasses of corporate directors.[169] This is where things inevitably become slippery[170] and where we move beyond the outer fringes of, and transcend, those models of the firm that are artificially centered around assumptions (or test conditions) of rational choice, zero transaction costs, perfect information and observable and verifiable calculative behavior of individual (including directorial) actors.[171]

166. *Cf.* Hart, *An Economist's View*, *supra* note 3, at 310.

167. *See*, *e.g.*, Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse*, 87 WASH. U. L. REV. 115, 128-36 (2009); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999); Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493 (2005).

168. *Cf.* O'Kelley, *The Entrepreneur*, *supra* note 3, at 754; Klein, *supra* note 84, at 16. The classical and then neoclassical economic position is that the political, economic and legal systems need to provide (i) strong legal protection of the entrepreneur's property right to own and control productive assets, as well as (ii) strict limits on the power of state actors to regulate and control economic activity. *See, e.g.*, Harold Demsetz, *The Theory of the Firm Revisited*, *in* THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 159, 159-60 (Oliver E. Williamson & Sidney G. Winter eds., 1993).

169. *Cf.* Stout, *Proper Motives, supra* note 12 ("internal gyroscope").

170. *Cf.* Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1699 (1996); Stout, *Proper Motives, supra* note 12, at 9.

171. *See*, *e.g.*, Demsetz, *supra* note 168, at 161 ("The only management task that seems to remain, and which is the focus of attention in the firm of traditional price

IV. THE MACROTHEORETICAL CORE: NORMS AND SELF-ENFORCING CONTRACTS

Pursuant to the *absolute director primacy model*, directorial decisionmaking power is absolute.[172] Directors have complete discretion to make corporate decisions by fiat and without any legal accountability for the substance of their decisions (as long as there is no implication of self-interest). Directorial behavior based on unrestricted power is, thus, completely opportunistic. This represents the core dilemma of the *absolute director primacy model* and requires an inquiry into the protolegal realm of directorial behavior.

By this, I mean the following: economists, simply but profoundly (and both in equal measures), explain individual economic choice and behavior dialectically as the confrontation of preferences or tastes and

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theory, is the selection of profit-maximizing quantities of outputs and inputs. But, since the required information for doing this is also freely at hand, and the required calculations are costless to make, the model strips management of any meaningful productivity in the performance of even these tasks. The *cost of maximizing* is ignored or implicitly assumed to be zero. De facto, the resources that might be required to make maximizing decisions are treated as if they are not scarce.") (footnote omitted) (emphasis in original); Mitchell, *Trusted*, *supra* note 13, at 596; Ripken, *supra* note 33, at 165; Sheehy, *supra* note 59, at 22. *See also* ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 53-55 (1990) (summarizing the assumptions underlying neoclassical economic theory, including (i) that economic actors always behave rationally and in a self-interested manner, and (ii) that economic actors have complete and perfect information available in their pursuit of economic opportunities); North, *Structure and Performance*, *supra* note 143, at 964 (summarizing the same assumptions as "(1) perfectly competitive markets, (2) perfectly specified and costlessly enforced property rights, (3) neutral government, and (4) unchanging tastes."). The artifice of those test conditions (as well as their cumulative effect) has, of course, been famously parodied by economist and Nobel laureate George Stigler in his *Conference Handbook*. George J. Stigler, *The Conference Handbook*, 85 J. POL. ECON. 441 (1977). According to his *Handbook*, all we need to say here for support of the point made above is "9-13-14-16-23-24-30" which numerical labels stand for, respectively: "The conclusions change if you introduce uncertainty." "The market cannot, of course, deal satisfactorily with that externality." "But what if transaction costs are not zero?" "Of course, if you allow for the investment in human capital, the entire picture changes." "The motivation of the agents in this theory is so narrowly egotistic that it cannot possibly explain the behavior of real people." "The flabby economic actor in this impressionistic model should be replaced by the utility-maximizing individual." "The paper is rigidly confined by the paradigm of neoclassical economics, so large parts of urgent reality are outside its comprehension."

172. Reich-Graefe, *supra* note 10.

opportunities.[173] If a director is faced with limitless opportunities (at least, in principle), any attempt at modeling directorial behavior with sufficient predictive ability requires the study of directorial preferences—namely, what they are, how they work and how such preferential system underlying directorial behavior comes about in the first place. Given the apparent standardization, selective restriction and, thus, decisional discipline of directorial behavior in the face of a limitless range of opportunities in the real world of corporate practice, we will also need to study whether there exists a preferential phenomenology. Arguably, there must be a common core of protolegal implications and foundations of interpersonal cooperation that not only applies to directorial decisionmaking but that repeatedly produces like outputs from similar inputs so that we can arrive at explanations and models with (at least, some) predictive accuracy—and without operating this process in a black box.

Obviously, this is the "slippery"[174] realm of (supposedly) "ugly"[175]

173. *See*, *e.g.*, Cooter & Eisenberg, *supra* note 61, at 1725; North, *Structure and Performance*, *supra* note 143, at 963.

174. Posner, *supra* note 170, at 1699 ("The concept of a 'norm' is slippery, and scholars use it in different ways."); Stout, *Proper Motives*, *supra* note 12, at 9 (asking "how can we gain a firm grasp on such soft and slippery concepts" as honor, integrity, trustworthiness and responsibility).

175. Gilson & Kraakman, *supra* note 104, at 604 n.21. *Cf.* Friedman, *supra* note 104 (arguing that "the doctrine of 'social responsibility' involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses"); Gilson, *supra* note 58, at 147 (pointing out that "markets encourage a management and governance structure that fits the corporation's business" and that "[c]orporate law has nothing to add to the process"). *But cf.* Hansmann & Kraakman, *supra* note 58 ("As a normative matter, the overall objective of corporate law—as any branch of law—is presumably to serve the interest of society as a whole."); Mitchell, *Trust and Team*, *supra* note 50, at 870 (describing the understanding of corporate organization in terms of team production not only as a "tale […] of economics alone" but also as "to conceive of the corporation as a political institution" and "as a social institution"); Wallman, *Understanding*, *supra* note 10, at 809-10 (concluding that corporate governance must be aimed at maximizing "societal wealth over the long term"). To me, it is not clear what should be "ugly" about this problem, other than that it perhaps taints the (perceived or aspired) purity and sanctity of corporate theoretical models. I would simply argue that a *pure* (i.e., non-normative) corporate law (or any law for that matter) does not—and, because it is a complete human fiction anyhow, logically cannot—exist. The perceived 'ugliness' may, therefore, have more to do with personal attitudes and preferences (and I mean this only descriptively); some observers simply may "get real 'squirrelly,'" Lawrence

normative research.[176] However, norms do matter.[177] Without an effective external (legal) constraint on directorial decisionmaking, it seems necessary to explain the phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment* by "something" else—namely, a repetitive internalization of normative standards into directorial preferences with resulting standardized, normative decisional outputs. In other words, internal values manifested by the decisionmaking choices of directors made over and over again (*i.e.*, by personal preferences) drive directorial behavior.[178] Not only then, do directors have preferences to adhere to normative standards, but their preferences affect aggregate behavior in equilibrium.[179] They coagulate into normative, protolegal variables that could help us understand and explain why corporate governance works without corporate law constraints. Moreover, since the protolegal realm is significantly larger and richer than what has been—or, theoretically, can be—distilled down from it into the legal vessels of corporate governance, norms must have the central role (*i.e.*, not just a supplementary role *vis-à-vis* corporate law) in achieving the objective of *ex-ante* determinability of directorial behavior in the absence of *ex-post-investment* accountability constraints.[180]

Put differently, one may argue that everything within corporate governance (magically)[181] works by itself and the law can sit back and stay

Raful, *What Balance in Legal Education Means to Me: A Dissenting View*, 60 J. LEGAL EDUC. 135, 135 (2010), when they hear what must sound to them as being "diffuse" and "confusing" at best (*cf.* Williamson, *Calculativeness*, *supra* note 85, at 469) or as being "new age stuff" at worst (*cf.* Raful, *supra*). *See also* Kysar, *supra* note 104, at 22 ("More than one commentator has speculated that the disappearance of limits in macroeconomics serves as a theoretical expedient to avoid difficult questions of distribution."); Lee, *supra* note 10, at 575 ("The terms 'morality' and 'justice' may raise red flags for readers skeptical of deontology and inclined toward consequentialism."); Posner, *supra* note 170, at 1699 ("Norms are fuzzy."). *See also* Mitchell, *Norms*, *supra* note 149, at 203 ("Norms are fuzzy because people are fuzzy and life is fuzzy.") (footnote omitted).

176. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 596.

177. John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2175 (2001).

178. *Cf.* Cooter & Eisenberg, *supra* note 61, at 1726.

179. *Id.* at 1726 .

180. *Cf. id*. at 1720.

181. *See supra* note 62 and accompanying text.

out of it[182] since "we are blissfully in Nash equilibrium."[183] Instead of a corporate reality of opportunistic directorial shirking as the norm, we get a corporate reality of directorial diligence, fairness, efficiency and competence as the norm because directors are committed to, and simply apply, their own, internalized normative agenda to the task at hand (*i.e.*, making decisions in good faith and the reasonable belief that they are in the best interest of the corporation).[184] In other words, corporate directors are "good"[185] *Macbeths* whose fiduciary obligation is entirely self-enforcing.[186]

> The service and the loyalty I owe,
> In doing it, pays itself. Your highness' part
> Is to receive our duties: and our duties
> Are, to your throne and state, children and servants;
> Which do but what they should, by doing every thing
> Safe toward your love and honour.[187]

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182. *Cf.* Langevoort, *supra* note 12, at 800 ("[T]he law played a relatively minor role in the evolution of board structure and behavior . . . ."); Robert B. Thompson, *Corporate Law Criteria: Law's Relation to Private Ordering*, 2 BERKELEY BUS. L.J. 95, 99 (2005) ("[L]aw defers to other regulators of human behavior when . . . alternative regulators have a relative advantage. . . . Law is humble."). *See also* Gilson, *supra* note 58, at 147 ("The point is that markets encourage a management and governance structure that fits the corporation's business. Corporate law has nothing to add to the process."); Mitchell, *supra* note 118 ("Law has its limits."); *id.* at 165 ("Perhaps the best corporate law is no law at all.").

183. Bruce Chapman, *Trust, Economic Rationality, and the Corporate Fiduciary Obligation*, 43 U. TORONTO L.J. 547, 586 (1993). In game theory, a Nash equilibrium designates a state in which no player can any longer improve her personal outcome/pay-off through unilateral changes in her chosen game strategy. *Id.* at 586 n.74.

184. *See* Cooter & Eisenberg, *supra* note 61, at 1723. *See also* Cooter, *supra* note 149, at 1661-63; Mitchell, *Norms*, *supra* note 149, at 197.

185. I am talking about the beginning of Shakespeare's *Macbeth*, when the protagonist is bravely and unselfishly leading the Scottish defensive forces against the Norwegian intruders under Sweno, the King of Norway, and the original "Thane of Cawdor," a Scottish defector and traitor fighting alongside the Norwegians. At such time, Macbeth is not besieged by the lust for power (which we often euphemistically call "control") and greed (ditto: "wealth maximization")—though Shakespeare already labels him "Bellona's bridegroom" (i.e., as the husband of the goddess of war and as apparently already having replaced Mars, the god of war).

186. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 614.

187. WILLIAM SHAKESPEARE, MACBETH act I sc. IV. Macbeth is addressing Duncan,

If only we could find out how corporate directors attain and apply their respective moral compasses; how they become and stay good self-enforcing *Macbeths*; and whether all of that indeed happens in today's corporate reality. We certainly are trying to figure this out, as the "slippery" realm of normative research is already under intense investigation[188]—both in the economic literature on norms in organizations (usually rubricated under the heading of "self-enforcing" or "self-governing" contracts),[189] and in the focus of legal academia on the co-existence of (corporate) law and norms and the latter's influence on (and, maybe, over) the former (the so-called "law and norms" literature).[190]

It certainly is already possible to come up with a (perhaps, necessarily eclectic) list of what could be called "protolegal prolegomena of directorial accountability" that all seem part and parcel of the preferential phenomenology of "good" director conduct. Many of such prolegomena are concepts that, unsurprisingly, have become heavily reflected within corporate law (indeed, within many other fields of private law). The list includes (without limitation):

- trust[191] and trustworthiness;[192]

King of Scotland, after leading the Scottish forces to victory during the battle at Fife. Duncan is immensely grateful and states that "[m]ore is thy due than more than all can pay" (to which Macbeth responds the above). *Id.* Banquo, a Scottish general who fought alongside Macbeth, similarly responds to Duncan's gratitude (which includes promises of wealth and honor within the King's embrace) with notions of duty, humility and selflessness: "There if I grow, The harvest is your own." *Id.*

188. *Cf.* Mitchell, *Norms*, *supra* note 149, at 179.

189. *See*, *e.g.*, Hart, *Norms and Theory*, *supra* note 38, at 1703; Rock & Wachter, *supra* note 9, at 1609; *id.* at 1613.

190. *See*, *e.g.*, Cooter & Eisenberg, *supra* note 61, at 1717; Jones, *supra* note 15, at 121-24; Kahan, *supra* note 5, at 1870; Rock & Wachter, *supra* note 60, at 434; Rock & Wachter, *supra* note 5, at 1621. To give an example: Lawrence Mitchell has developed a "trust model" of the firm, which centers around the breach of implicit 'contracts' by corporate directors. Such 'contracts' embody the good faith expectations of various firm constituencies. *See* Mitchell, *Trust and Team*, *supra* note 50, at 871, 899. *See also* Wallman, *Understanding*, *supra* note 10, at 808 (mentioning "good faith expectations" which employees and other affected communities "were told to trust").

191. ARROW, *supra* note 28, at 23; Dent, *supra* note 10, at 1221; Hart, *Norms and Theory*, *supra* note 38, at 1702; Mitchell, *Trust and Team*, *supra* note 50, at 870; Rock & Wachter, *supra* note 9, at 1609. With regard to the norm of "trust," Lawrence Mitchell describes the corporate law dilemma that is the topic of this Article well when he states: "To trust is, in my own field of corporate law, to be willing to invest your money in a corporation managed by people you have never seen, you have never met, about

- (good) faith[193] and faithfulness;[194]
- loyalty;[195]
- fairness;[196]
- guardianship[197] and duty;[198]
- sense of honor;[199]
- sense of obligation[200] and responsibility;[201]
- honesty (truthfulness)[202] and integrity;[203]
- confidence;[204]
- (moral) character[205] and decency;[206]

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whom you know very little, and some of whose names you may not know at all." *See* Mitchell, *Trusted*, *supra* note 13, at 599. *See also* Stout, *Investor Confidence*, *supra* note 51, at 407-08.

192. Alces, *supra* note 42, at 241; Chapman, *supra* note 183, at 583; Hart, *Norms and Theory*, *supra* note 38, at 1714; Mitchell, *Trusted*, *supra* note 13, at 597; Stout, *Investor Confidence*, *supra* note 51, at 416; Stout, *Proper Motives*, *supra* note 12, at 9.

193. Mitchell, *Trust and Team*, *supra* note 50, at 871, 899; Stout, *Investor Confidence*, *supra* note 51, at 411; Wallman, *Understanding*, *supra* note 10, at 808.

194. *Cf.* Johnson, *supra* note 63, at 5, 25-28; Meurer, *supra* note 53, at 740; Stout, *Mythical Benefits*, *supra* note 57, at 797.

195. Mitchell, *Trust and Team*, *supra* note 50, at 870. *See also* Gambetta, *supra* note 85, at 218 n.9 ("*Loyalty*, in this context, can perhaps be seen as the maintenance of global trust – in a person, a party, an institution – even in circumstances where local disappointments might encourage its withdrawal.") (emphasis in original).

196. Avner Ben-Ner & Louis Putterman, *Trusting and Trustworthiness*, 81 B.U. L. REV. 523, 529 (2001); Hart, *Norms and Theory*, *supra* note 38, at 1703; Meurer, *supra* note 53, at 744 ("fair dealing"); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 425-26 (1993) [hereinafter Mitchell, *Fairness*]; Stout, *Investor Confidence*, *supra* note 51, at 424.

197. Bainbridge, *Primacy*, *supra* note 12, at 550-51 n.21 ("Platonic guardians"); Cox & Munsinger, *supra* note 66, at 84 ("faithful guardians").

198. Bainbridge, *Primacy*, *supra* note 12, at 550-51 n.21; Kahan, *supra* note 5, at 1870; Mitchell, *Trust and Team*, *supra* note 50, at 870.

199. Stout, *Proper Motives*, *supra* note 12, at 8.

200. Kahan, *supra* note 5, at 1872; Stout, *Proper Motives*, *supra* note 12, at 9.

201. Stout, *Proper Motives*, *supra* note 12, at 18.

202. Ben-Ner & Putterman, *supra* note 196, at 529 ("truth-telling"); Cooter & Eisenberg, *supra* note 61, at 1723 (2001); Grossman, *supra* note 53, at 466; Hart, *Norms and Theory*, *supra* note 38, at 1702.

203. Hart, *An Economist's View*, *supra* note 3, at 306; O'Kelley, *The Entrepreneur*, *supra* note 3, at 767; Stout, *Proper Motives*, *supra* note 12, at 9.

204. Alces, *supra* note 42, at 241; O'Kelley, *The Entrepreneur*, *supra* note 3, at 769.

205. Ben-Ner & Putterman, *supra* note 196, at 528; Chapman, *supra* note 183, at 582; Cooter & Eisenberg, *supra* note 61, at 1726; Mitchell, *Trusted*, *supra* note 13, at

- reputation,[207] prestige[208] and credibility;[209]
- corporate culture;[210]
- generosity[211] and altruism;[212] and
- affinity[213] and empathy.[214]

These protolegal values and attributes form the very core of directorial legal (if only, aspirational)[215] mandates imposed by American corporate law.[216] I argue that a fully developed understanding of their re-

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599; Stout, *Investor Confidence*, *supra* note 51, at 425; Stout, *Proper Motives*, *supra* note 12, at 20.

206. Hart, *Norms and Theory*, *supra* note 38, at 1703; Lee, *supra* note 10, at 572.

207. Ben-Ner & Putterman, *supra* note 196, at 527-28; Dooley, *supra* note 6, at 525; Cooter & Eisenberg, *supra* note 61, at 1721; Hart, *An Economist's View*, *supra* note 3, at 306; Hart, *Norms and Theory*, *supra* note 38, at 1714; Meurer, *supra* note 53, at 742-45; Rock & Wachter, *supra* note 9, at 1613; Smith, *supra* note 50, at 969; Stout, *Proper Motives*, *supra* note 12, at 7.

208. Cox & Munsinger, *supra* note 66, at 94; Elhauge, *supra* note 35, at 752.

209. Chapman, *supra* note 183; Rock & Wachter, *supra* note 9, at 1611.

210. Meurer, *supra* note 53, at 745; Ripken, *supra* note 33, at 133-38; Rock & Wachter, *supra* note 5, at 1642; Rock & Wachter, *supra* note 9, at 1608. Other synonyms may be used for this "norm" including "being, core, . . . ethos, identity, ideology, manner, patterns, philosophy, purpose, roots, spirit, style, vision, and way." STANLEY M. DAVIS, MANAGING CORPORATE CULTURE 1 n.1 (1984).

211. Cooter & Eisenberg, *supra* note 61, at 1723.

212. Ben-Ner & Putterman, *supra* note 196, at 529; Blair & Stout, *Trustworthiness*, *supra* note 5, at 1809-10 ("concern for others"); George W. Dent, Jr., *Race, Trust, Altruism and Reciprocity*, 39 U. RICH. L. REV. 1001, 1001 (2005) [hereinafter Dent, *Race*]; Jones, *supra* note 15, at 125; Stout, *Proper Motives*, *supra* note 12, at 1, 12.

213. Mitchell, *Trusted*, *supra* note 13, at 608, 615 (describing how the importance of being able to trust a partner in a fiduciary relationship, and the importance of being trustworthy, can rise to the level of the intimacy of marriage itself).

214. Mitchell, *Trusted*, *supra* note 13, at 608.

215. Bainbridge, *Abstention Doctrine*, *supra* note 6, at 89 n.37; Garza, *supra* note 14, at 629; Ibrahim, *supra* note 6, at 934; Mitchell, *Trusted*, *supra* note 13, at 613-14; Rock, *supra* note 14, at 1015; Rock & Wachter, *supra* note 9, at 1608. *See also* Rock & Wachter, *Corporate Law as a Facilitator*, *supra* note 14, at 529. ("[O]ne should think of fiduciary duty cases as judicial sermons that exhort managers to consummate performance and that criticize those who perform below expectations, even if, or perhaps especially when, no direct legal sanction is imposed.") (footnote omitted).

216. *Cf.* Alces, *supra* note 42, at 241 ("Beneficiaries want to rely on someone else's expertise and think it is in their best interests to trust, rather than directly control, the fiduciary. This focus on trust rather than direct monitoring or control is the hallmark of fiduciary law."); Mitchell, *Trusted*, *supra* note 13, at 597; *id.* at 614 ("Fiduciary duty is, famously, about trust."); Rock, *supra* note 14, at 1097 ("[F]iduciary duty law evolves primarily at the level of norms rather than the level of rules."). *See also* Luhmann,

spective operation in the black box of corporate governance constitutes a first step in the process of unveiling the truly controlling variables behind observable, standardized and compliant director behavior, on the one hand, and absolute director primacy in a world without effective legal means for director accountability, on the other hand.

V. THE MACROTHEORETICAL DILEMMA: NORM ACTUATION UNEXPLAINED

Each macrotheoretical model that reverts—by definition—to some of the above normative concerns (and, thus, allows directorial self-expectations and moral standards to enter the modeling equation) must explain how these protolegal foundations of interpersonal relationships and cooperation, in the reality of corporate governance, become actuated in directorial decisionmaking behavior. Such explanation of norm actuation also must unveil the forces and devices employed in order to (i) deploy norms and foster norm perception with general latency and command (*i.e.*, "this is—under any and all circumstances—the generally expected and accepted behavior of a corporate director")[217] and (ii) actuate norms with precise specificity and command (*i.e.*, "this is the 'proper,' hence acceptable and expected, directorial behavior under these particularized circumstances"). Those forces and devices, furthermore, must be extremely powerful,[218] as well as extremely efficient, in order to sufficiently discipline and standardize individualistic (if not, opportunistic) directorial behavior naturally faced with a limitless spectrum[219] of decisional opportunities and options. How else to guarantee both the vast repetition of "proper" directorial behavior and the limited instances and variety of "improper" directorial behavior (*i.e.*, misbeha-

Familiarity, *supra* note 51, at 94 (discussing Bernhard Barber's differentiation of "three dimensions in which trusting expectations may fail" and including therein as one dimension "the fiduciary obligations of actors, that is, their duty and their motives to place the interests of others before their own;" BERNHARD BARBER, THE LOGIC AND LIMITS OF TRUST (1983)).

217. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1798. Norm actuation seems to occur with vast amounts of standardized normative repetition and relatively marginal instances of normative deviation from the standard, both within individual directors and among the whole spectrum of corporate boards.

218. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 602.

219. *Cf.* Mitchell, *Trust*, *supra* note 23, at 190.

vior) that we seem to be able to observe within the marketplaces of corporate reality?

Two realms exist in which norm actuation may happen.[220] The first realm is based on technique and perception (*i.e.*, norm actuation is "cognitive-based"), while the second realm is based on internalization and authenticity (*i.e.*, norm actuation is "affect-based").[221] With regard to the former, corporate directors may have a fairly standardized perception of what is expected of them and how they need to behave to meet such external expectations and, accordingly, to make themselves look good (both before others and before themselves).[222] The actuation of normative concerns within directorial decisionmaking may therefore be merely intuitive, unconscious and reflexive (*i.e.*, not much, if any, thought is given to what the "right" behavior should be, because it naturally "feels" to fall in line with standard and generally accepted behavior of directors and, thus, feels appropriate[223]).[224] Alternatively, norm actuation as part

220. Cooter & Eisenberg, *supra* note 61, at 1722.

221. *See*, *e.g.*, the distinction usually made in organizational psychology between cognitive-based trust (which is based on the knowledge and recognition of the fiduciary's reliability, dependability, and competence) and affect-based trust (which depends on the investment and reciprocation of the fiduciary's genuine care and concern for the welfare of others); *see* Burke & Stets, *supra* note 26, at 361-62; Daniel J. McAllister, *Affect- and Cognition-Based Trust as Foundations for Interpersonal Cooperation in Organizations*, 38 ACAD. OF MGMT J. 24, 25-26 (1995); Mitchell, *Trusted*, *supra* note 13, at 608.

222. This cognitive process is usually described as "self-verification." *See* Burke & Stets, *supra* note 26, at 347. *See also* Cox & Munsinger, *supra* note 66, at 94 ("Through attachment to a group, especially one of high prestige, individuals satisfy their needs to validate their self-worth, particularly by the group's feedback."). Warren Buffet once described this cognitive process as "elephant bumping" (Warren E. Buffet, et al., *Hostile Takeovers and Junk Bond Financing: A Panel Discussion*, *in* JOHN C. COFFEE ET AL., KNIGHTS, RAIDERS, AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 10, 14 (1988) ("I mean [corporate leaders] like to go to the places where other elephants are, because it reaffirms the fact that when they look around the room and they see all these other elephants that they must be an elephant too, or why would they be there?").

223. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1798.

224. Such reflexive adherence—i.e., directors intuitively and unquestioningly believe in a particular norm—might, for example, explain the prevalence of shareholder value constructs in the corporate governance debate. In other words, shareholder value is believed to be a norm in itself that reflexively and self-referentially replicates itself. *Cf.* Kaushik Basu, *Social Norms and the Law*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, 476, 477 (2002) (describing how certain norms stop us

of directorial behavior may be deliberate, calculative and instrumental (*i.e.*, behavior is purposefully structured to signal[225] to others that a particular normative agenda is at play and controlling the decisionmaking—whether that is indeed the case or not).[226] In the latter variant, where the normative directorial footprint becomes part of the firm's social capital,[227] it would be possible, at least in theory, to employ techniques to develop a regime of firm-specific norms (for example, norms of a firm that require fair conduct by its agents)[228] that can then be signaled to markets in order to build (additional) social capital in the form of reputational net gains.

Furthermore, with regard to external motivational forces behind directorial behavior, it is possible to link this first realm of norm actuation with the remedial side of *ex-post* social sanctions (as opposed to nonexistent legal sanctions), such as guilt, disapprobation and other shaming exercises[229] that, in the case of noncompliance with norms, would lead to reputational net losses[230] and, in the case of normative compliance, would lead to net gains in reputation (*i.e.*, to being perceived as a good moral actor and conscientious corporate director).[231] Fear of shaming

"from doing certain things or choosing certain options, irrespective of how much utility that thing or option gives us"); Cooter & Eisenberg, *supra* note 61, at 1723; Elhauge, *supra* note 35, at 752.

225. *Cf.* Gambetta, *supra* note 85, at 216 ("The problem, therefore, is essentially one of communication: even if people have perfectly adequate motives for cooperation they still need to know about each other's motives and to trust each other, or at least the effectiveness of their motives. It is necessary not only to trust others before acting cooperatively, but also to believe that one is trusted *by* others.") (emphasis in original).

226. *See*, *e.g.*, Coffee, *supra* note 177, at 2152; Cooter & Eisenberg, *supra* note 61, at 1722; Mitchell, *Trusted*, *supra* note 13, at 597. *See also* Lee, *supra* note 10, at 572 ("People act morally because their utility responds to 'social and moral sanctions.'").

227. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 596-97; Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 567-68 (2001) [hereinafter Ribstein, *Law v. Trust*].

228. Cooter & Eisenberg, *supra* note 61, at 1719.

229. *See*, *e.g.*, Elhauge, *supra* note 35, at 752; Ribstein, *Law v. Trust*, *supra* note 227, at 564; Rock, *supra* note 14, at 1104; David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1814-15 (2001).

230. *See*, *e.g.*, Rock & Wachter, *supra* note 60, at 430.

231. *See*, *e.g.*, Jones, *supra* note 15, at 108; Meurer, *supra* note 53, at 744 ("Reputation works in the larger commercial community to promote efficient performance."); Stout, *Proper Motives*, *supra* note 12, at 7. With regard to the norm of "trust," Lawrence Mitchell has described this process well when he defines "trust" as follows: "To be trusted is to be held accountable for the trust reposed by the truster, to be held to a standard of behavior that allows these very important relationships to form and be sus-

and the personal non-comfort or pain of feeling guilty will make directors stay the line of "proper" decisional behavior (at least, in an overwhelming majority of cases) by internally monitoring—either reflexively or calculatively—their external perception.[232]

The second realm of norm actuation is more difficult to describe because it abstracts entirely from common neoclassical approaches to managerial behavior—namely calculated "carrots" (*i.e.*, external rewards) or calculated "sticks" (*i.e.*, external sanctions).[233] This realm is not about external incentives or pressures influencing directorial decisionmaking.[234] It is about neither sticks nor carrots, but about internal pressures that may be prevalent in a given director's moral psychology[235] and, thus, may influence (if not, overwrite) any opportunistic behavioral tendencies of such director. The argument goes like this: from the perspective of an investor, "a fair degree of reliance"[236] on the soundness, fairness and diligence of directorial behavior *ex-ante* (in order to allow for firm-specific investments to be made with confidence) may be—and, maybe, even should be—the result of "correct" *ex-ante* directorial internalizations of moral imperatives.[237] In other words, directors act (or, at least, attempt to act) with authenticity and as genuine moral actors, thereby avoiding all moral hazards that would otherwise allow them to shirk on their performance, since they would not be run-

tained, and to be held responsible by social approbation, feelings of failure and guilt, and sometimes by law if that trust reposed is breached. Perhaps most importantly, to be trusted is to be told that we are trustworthy. And to be told that we are trustworthy demands that we behave at a level that reflects that gift." *See* Mitchell, *Trusted*, *supra* note 13, at 599.

232. *Cf.* Kahan, *supra* note 5, at 1870; Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338, 340 (1997); Mitchell, *Trusted*, *supra* note 13, at 616. *See also* Lee, *supra* note 10, at 572 ("In other words, in addition to the utility they derive from the satisfaction of their own interests, individuals derive positive utility from praise and feelings of virtue and they experience disutility from criticism and feelings of guilt.") (footnote omitted).

233. *Cf.* Grossman, *supra* note 53, at 466; Stout, *Investor Confidence*, *supra* note 51, at 425; Stout, *Proper Motives*, *supra* note 12, at 4.

234. Stout, *Proper Motives*, *supra* note 12, at 8.

235. *See* Mitchell, *Trusted*, *supra* note 13, at 602.

236. ARROW, *supra* note 28, at 23.

237. *See* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1794; Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1258-61 (1999); Mitchell, *Trusted*, *supra* note 13, at 597; *id.* 602; Rock, *supra* note 14, at 1013; Stout, *Proper Motives*, *supra* note 12, at 18.

ning any risk of legal repercussions or social sanctions. They do this simply by way of internalized, normative reactions. Corporate directors are (pre-)conditioned to behave well.[238] To conveniently avoid any need for applicable legal constraints, all we need to do is detect and select (and know how to detect and select) the good moral agents who will have such internalized, normative reactions.[239] Therefore, this second realm of norm actuation is less dependent on *ex-post* external sanctions (social or legal). Rather, it emphasizes *ex-ante* internalized social behavior in corporate directors (which may, or may not, lead to internal rewards, such as simply feeling good about how one has acted in a particular situation and feeling in sync with one's personal moral compass and own conscience).[240]

How and when such *ex-ante* internalization within the second realm of norm actuation comes about, however, is extremely difficult to ascertain.[241] For example, we need to explain how the substance of such norm internalization is achieved in order to coincide and significantly overlap with (apparently) some sort of majoritarian default of moral "rightness" in corporate reality. Furthermore, we need to understand how such majoritarian default is sufficiently and effectively signaled to the different marketplaces of firm investors to entice such investors to make (often sunk) firm-specific investments with confidence.[242] Finally, and perhaps most importantly, we need to find out how such internalized

238. *Cf.* Chapman, *supra* note 183, at 585 ("But the incumbent managers in the Shleifer and Summers argument are not loyal or trustworthy for instrumental reasons at all. The simply *are* loyal in virtue of the actual lives they have lived, and the promises they have made.") (emphasis in original) (discussing Andrei Shleifer & Lawrence Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33 (A. Auerbach ed., 1988)); Grossman, *supra* note 53, at 466 ("Perhaps a better approach is to make directors *want* to do the right thing.") (emphasis in original); Ribstein, *Law v. Trust*, *supra* note 227, at 553-54 ("Trusting people cooperate because it is in their nature or because they have been socialized to do it, not because some costly structure has been set up to ensure reliability.").

239. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 612.

240. *Cf.* Burke & Stets, *supra* note 26, at 347; Elhauge, *supra* note 35, at 752 ("pleasurable feelings of virtue, inner peace, or satisfaction").

241. Cooter & Eisenberg, *supra* note 61, at 1728.

242. Gambetta, *supra* note 85, at 216 ("The problem, therefore, is essentially one of communication: even if people have perfectly adequate motives for cooperation they still need to know about each other's motives and to trust each other, or at least the effectiveness of their motives. It is necessary not only to trust others before acting cooperatively, but also to believe that one is trusted *by* others.") (emphasis in original).

normative majoritarian agenda is exercised consistently over an infinite continuum of different individual directors, corporate boards, decisional substances, cultural contexts, and points in time.[243] Only such consistent and continuous exercise (*longa consuetudo*) allows any normative majoritarian agenda to sufficiently and efficiently affect absolute directorial decisionmaking power so that the vast majority of board decisions made (*i.e.*, the output determinations in the decisional black box described above) are, at a minimum, perceived as "correct," "fair" or, at least, "tolerable enough" so that firm participants remain involved and invested on a going-forward basis. Here, we are eventually talking about (and are thinking about ways to pre-evaluate) "good agent character" and how firms select for good agent character and have efficient insight into good moral character in the first place to select good agents. This, to date, is at best a mostly unexplained and rather mysterious process.[244]

A Taoist[245] or mysticism-based[246] approach to the accountability

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243. *Cf.* Mitchell, *Trust*, *supra* note 23, at 190. In this regard, the theory of "groupthink" developed in organizational psychology requires more of our attention. Groupthink has been described as the dynamic process by which group members unconsciously forgo their respective abilities to make realistic and internally validated individual adaptive decisions for the sake of conformity with, and commitment to, a group mode of thinking and deciding which will then often morph—for purposes of group cohesion and collective orientation—into a group *esprit de corps* and rapport and into what has been described as "homosocial reproduction." *See, e.g.*, IRVING L. JANIS, GROUPTHINK: PSYCHOLOGICAL STUDIES OF POLICY DECISIONS AND FIASCOS (1982); ROSABETH MOSS KANTER, MEN AND WOMEN OF THE CORPORATION 48, 63 (1977) (coining the term "homosocial reproduction"); Marlene A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003). *See also* Cox & Munsinger, *supra* note 66, at 92-95; Jones, *supra* note 15, at 139-41; Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313, 340 (2007); Ripken, *supra* note 33, at 132-33.

244. *Cf.* Stout, *Proper Motives*, *supra* note 12, at 3, 8.

245. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 606.

246. GILBERT K. CHESTERTON, ORTHODOXY 48 (1908) ("Mysticism keeps men sane. As long as you have mystery you have health; when you destroy mystery you create morbidity. The ordinary man has always been sane because the ordinary man has always been a mystic. He has permitted the twilight. He has always had one foot in earth and the other in fairyland. He has always left himself free to doubt his gods; but (unlike the agnostic of to-day) free also to believe in them. He has always cared more for truth than for consistency. If he saw two truths that seemed to contradict each other, he would take the two truths and the contradiction along with them."). *See also* ANTOINE DE SAINT-EXUPÉRY, THE LITTLE PRINCE 63 (Richard Howard trans., Harcourt 2000) (1943) ("One sees clearly only with the heart. Anything essential is invisible to the

conundrum of directorial behavior would probably claim that such process will always remain unexplained and, thus, mysterious. However, I believe that something more can be done, at least, in principle. Let us take as an example the protolegal variable that arguably constitutes the very heart of the fiduciary relationship between corporate directors and the corporation as an aggregation of factors of production: trust.

Decisional discretion by some over recognized interests of others requires trust.[247] Much has been written about trust, the central "extra-legal"[248] norm of directorial behavior. For example, Lawrence Mitchell, one of the leading legal scholars on trust and trustworthiness in the realm of corporate law,[249] has developed a trust model of the firm that is built on the breach of implicit contracts that embody the good faith expectations of the various firm constituencies.[250] Moreover, Oliver Williamson, in his leading economic model of trust,[251] has famously stated that "calculative trust is a contradiction in terms"[252] since both terms—calculativeness and trust—are not only deemed mutually exclusive concepts (at least, on first blush), but "trust," as a diffuse, mixed-meaning and, thus, confusing term, is useless to explain economic transactions.[253] According to Williamson, the concept of calculativeness (*i.e.*, economic actors eliminate the need for trust by calculatively anticipating and allocating risk *ex-ante*) can instead explain the behavior of economic actors.[254] For Mitchell, extralegal norms like trust are part and parcel of all human relations (including those of economic, rational-choice actors),

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eyes.").

247. *Cf.* Epstein, *supra* note 85, at 9; Mitchell, *Fairness*, *supra* note 196, at 430; Mitchell, *Trust*, *supra* note 23, at 188.

248. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 615.

249. *See* Mitchell, *Fairness*, *supra* note 196; Lawrence E. Mitchell, *Trust and the Overlapping Consensus*, 94 COLUM. L. REV. 1918 (1994) [hereinafter Mitchell, *Overlapping Consensus*]; Mitchell, *Trust*, *supra* note 23; Mitchell, *Trust and Team*, *supra* note 50, at 870; Mitchell, *Norms*, *supra* note 149; Mitchell, *Trusted*, *supra* note 13.

250. Mitchell, *Trust and Team*, *supra* note 50, at 871, 899. *See also* Mitchell, *Fairness*, *supra* note 196; Mitchell, *Overlapping Consensus*, *supra* note 249; Mitchell, *Trust*, *supra* note 23; Mitchell, *Norms*, *supra* note 149; Mitchell, *Trusted*, *supra* note 13. *Cf.* Wallman, *Understanding*, *supra* note 10, at 808 (mentioning "good faith expectations" which employees and other affected communities "were told to trust").

251. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 603.

252. Williamson, *Calculativeness*, *supra* note 85, at 463.

253. *Id.* at 469. *See also* Epstein, *supra* note 85, at 10; Posner, *supra* note 170, at 1699.

254. Williamson, *Calculativeness*, *supra* note 85, at 463.

and those relations are "arranged along a spectrum of affinity" so that there is "a thread of human empathy even in the most calculating relationships."[255] As such:

> To be trusted is to be held accountable for the trust reposed by the truster, to be held to a standard of behavior that allows these very important relationships to form and be sustained, and to be held responsible by social approbation, feelings of failure and guilt, and sometimes by law if that trust reposed is breached. Perhaps most importantly, to be trusted is to be told that we are trustworthy. And to be told that we are trustworthy demands that we behave at a level that reflects that gift.[256]

In other words, trust is a reciprocal arrangement that mutually benefits both sides of the equation (*i.e.*, the exercise results in net gains of social/reputational capital for both parties).[257] However, the truster and the trustee must signal to each other their trustworthiness and willingness to actually trust, and then go through with the arrangement and play their designated roles in a well-behaved manner.[258] However, I am uncertain whether the expectational[259] demand made by a trusting person, merely based on the fact that I am simply perceived and told to be trustworthy (I might not be or might not want to be), is indeed a "gift" or whether it is rather a curse. For starters, I do not like to be told things. In particular, I do not like to be told what I am or am not, or more precisely, what I should be or should not be. I do not know—as a human being striving for my personal authenticity and autonomy free from any "trappings" of external validation—whether I even want to be trusted; whether I want to be held responsible (whatever that means in this context) by "social approbation" and "feelings of failure and guilt." Why should I care? Why should I let my moral compass and personal conscience be manipulated[260] in that way? I neither like to be shamed nor

255. Mitchell, *Trusted*, *supra* note 13, at 608.

256. *Id.* at 599.

257. *Cf.* Coffee, *supra* note 177, at 2151; Dent, *Race*, *supra* note 212, at 1002.

258. *Cf.* Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1724 (2006) ("[T]rust requires more than simple cooperation. It requires, in addition, a sense of entitlement to return beneficience.") (footnote omitted).

259. *Cf.* Gambetta, *supra* note 85, at 217 (describing trust as "a particular expectation we have with regard to the likely behaviour of others").

260. *Cf.* Stout, *Investor Confidence*, *supra* note 51, at 437 ("Experienced policymakers and businesspeople (and certainly experienced con artists) have long known that

framed.[261]

In other words, I believe that, in contrast to the Williamsonian worldview in which "[c]alculative trust is a contradiction in terms,"[262] calculative trust is rather a generally misunderstood tautology.[263] Trust and trustworthiness are *always* calculative.[264] They are designed to deal with the eternally present Knightian[265] uncertainty of future outcomes.[266]

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trust is a potent force in explaining and *manipulating* investor behavior.") (emphasis added).

261. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1796 ("In other words, *fiduciary duty law works through framing, not shaming.*") (emphasis in original). *See also* Ribstein, *Law v. Trust*, *supra* note 227, at 566. In this regard, *framing* is a similar organizational pressure aimed at invading and affecting individual preferences and behavior as is *shaming*. Thus, ultimately, it is a manipulative mechanism aimed at weakening (and dumbing down) the collective cognitive functioning of groups by enhancing the unconscious adherence to group norms and assumptions. *Cf.* Ramirez, *supra* note 243, at 340; Ripken, *supra* note 33, at 133-38.

262. Williamson, *Calculativeness*, *supra* note 85, at 463.

263. *Cf.* Stigler, *supra* note 171, at 442 ("21. The central argument is not only a tautology, it is false.").

264. I believe that Lawrence Mitchell reveals as much himself when he says that "[i]n the absence of trustworthiness, trusting not only would be irrational in a technical sense—it would be plain stupid." *See* Mitchell, *Trusted*, *supra* note 13, at 599. *See also* Mitchell, *Trust*, *supra* note 23, at 191 ("Trust derives centrally from our confidence in the trusted's intentions, specifically, that the trusted will act in the manner we expect her to."). In other words, trusting will only be extended 'rationally' if and once the truster, before trusting, has gone through an affirmatively satisfactory, calculative evaluation of whether there is enough ex ante trustworthiness in the person to be trusted. Otherwise, if I trust without this calculative, evaluative basis for trusting, I am acting irrationally. *See also* Williamson, *Calculativeness*, *supra* note 85, at 479 (explaining how calculative behavior needs to be suppressed in order to preserve the quality of the trust relationship and how the decision to suppress calculativeness may itself be calculative, thereby making it impossible to ever achieve pure non-calculative trust). Thus, my view is the opposite of the Williamsonian approach in that I believe that not calculative trust but that non-calculative trust is a contradiction in terms.

265. KNIGHT, *supra* note 3, at 109, 235, 223.

266. *Cf.* Gambetta, *supra* note 85, at 218 ("The condition of ignorance or uncertainty about other people's behaviour is central to the notion of trust."); McAllister, *supra* note 221, at 25 ("Trust enables people to take risks[.]"); Mitchell, *Trust*, *supra* note 23, at 191 (stating that "a major function of trust is to help us to reduce the uncertainty and complexity of society"). Uncertainty, of course, exists because of the lack of knowledge of what the future will bring, i.e. because of the lack of knowledge of all stochastic variables. *See, e.g.*, Alces, *supra* note 42, at 241-42; Bainbridge, *Primacy*, *supra* note 12, at 556 n.44; Meurer, *supra* note 53, at 739; Richter, *supra* note 5, at 175 n.22. *See also* Dooley, *supra* note 6, at 465 ("If there were no bounded rationality, including

They control behavior of others to produce preferential outcomes that, *ex-ante*, one cannot control (entirely) by oneself.[267] They are self-referential, autopoietic expectation exercises that always work both ways and lock both parties into a cohesive,[268] dyadic,[269] and requiting dance.[270] Why do we do this? Because it, apparently, is too hard for us human beings in post-capitalist[271] industrial societies to each be (or to, at least, try to be as much as humanly possible) individually autonomous, authentic and true to ourselves.[272]

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no limitations on human foresight or the ability to acquire and process information, individuals could write completely specified contingent contracts."); Gambetta, *supra* note 85, at 218 ("If we were blessed with an unlimited computational ability to map out all possible contingencies in enforceable contracts, trust would not be a problem.") (reference omitted).

267. *See* Gambetta, *supra* note 85, at 217 ("[T]rust (or, symmetrically, distrust) is a particular level of the subjective probability with which an agent assesses that another agent or group of agents will perform a particular action, both *before* he can monitor such action (or independently of his capacity ever to be able to monitor it) *and* in a context in which it affects *his own* action.") (emphases in original) (references omitted).

268. *Cf.* Burke & Stets, *supra* note 26, at 347 ("We suggest that the processes of establishing and maintaining self-verification contexts, and the positive self-feelings that result, lead to the development of interpersonal or group cohesiveness in the form of commitment, emotional attachment, and a collective orientation.").

269. *Id.*, at 348 ("Self-verification leads to positive self-evaluations and positive other-evaluations in the form of dyadic trust, and trust facilitates attachment to the other. This attachment should reveal itself not only in commitment to the other but also in positive feelings for the other and, we anticipate, in a collective orientation to the relationship.").

270. What I mean by this is that each truster is not only trusting but—simultaneously—signaling that she is trustworthy of being good at trusting. Likewise, each trustee is not only signaling that he is trustworthy but—at the same time—also trusting that the truster will reciprocate and appreciate the trustworthiness made available to her. Each party deals with a complete set of expectations, counter-expectations and expectation-expectations. *Cf. id.*, at 348; Hill & O'Hara, *supra* note 258, at 1724; McAllister, *supra* note 221, at 25.

271. *Cf.* Mitchell, *Trust and Team*, *supra* note 50, at 870.

272. *Cf.* Ribstein, *Law v. Trust*, *supra* note 227, at 555 ("[Trust] refers to the willingness to make oneself *vulnerable* to another without costly external constraints.") (emphasis added); Stout, *Investor Confidence*, *supra* note 51, at 415-16 (arguing that "rational expectation investors," i.e., those investors who do not trust but act and invest on a purely calculative basis, "protect themselves from exploitation by refusing to become *vulnerable* in the first place") (emphasis added). In general, I argue, that we do not appreciate our respective individual (but only perceived) vulnerabilities. There is no larger perceived vulnerability than our respective individual (and very real) mortality. Thus, trusting is merely an exercise in shadow-boxing—in dealing with the shadows

In my worldview, trust is double-blind calculativeness.[273] It is as calculated as rational choice but, perhaps, only feels more dignified and virtuous since it avoids the paradigm of a cold-blooded, hard-driven bargain.[274] However, when it is coupled with control exercises about future behavior of other human beings—in particular, when the control exercises are driven by such powerful corporate incentives as wealth maximization and control—then trust is calculative from its core to its very periphery.

Accordingly, trust is just a bargain, albeit on a higher-order level of

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of our perceptions of external costs rather than dealing with the internal, and entirely genuine wealth of our own existence. Accordingly, trust is always futile. It creates more distance from, rather than brings us closer to, our respective personal reality and truth.

273. *Cf.* Williamson, *Calculativeness*, *supra* note 85, at 480-81 (explaining that "the calculative approach can be taken to extremes" and that, for purposes of maintaining its functionality, calculative behavior sometimes needs to occur subconsciously and needs to be suppressed in order to preserve the quality of the trust relationship). *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1797 ("[T]rying to shore up trust behavior by making it easier for corporate participants to 'litigate trust' may produce the counterintuitive result of an increase in the incidence of the untrustworthy behavior."); *id.* at 1808-09; Gambetta, *supra* note 85, at 213-14 ("The unqualified claim that more cooperation than we normally get would be desirable . . . , if preached too extensively, may even have the effect of making cooperation less attractive.") (footnote and reference omitted); Hill & O'Hara, *supra* note 258, at 1793 ("We think that the window of actual liability for breaches of the duty of care should remain small. A larger window might encourage costly and inefficient levels of residual distrust, where directors are overly motivated to 'look for everything' and officers, feeling distrusted, are more apt to behave in an untrustworthy manner.") (footnote omitted); Jones, *supra* note 15, at 109 ("[T]he prospect of disproportionate penalties hinder the internalization of appropriate moral values by corporate leaders."); Langevoort, *supra* note 12, at 831 ("When the law becomes too aggressive, it risks altering the social dynamic of the board in a way that makes it less effective as a working group."); Mitchell, *Trusted*, *supra* note 13, at 606 ("It is almost as if, in a Tao-like way, Williamson believes that naming the reality destroys the relationship."); Stout, *Proper Motives*, *supra* note 12, at 18 ("The empirical evidence suggests that if we place too heavy a burden on [altruistic notions as, for example, the directors' internalized sense of responsibility], they will crumble under the weight.").

274. *Cf.* Mitchell, *Trusted*, *supra* note 13, at 600; Ribstein, *Law v. Trust*, *supra* note 227, at 563 ("Family members or close friends may eschew calculation of probabilities as inconsistent with the intimate bond between them."); Williamson, *Calculativeness*, *supra* note 85, at 486 (stating that personal, i.e., nearly noncalculative, trust "is warranted only for very special personal relations that would be seriously degraded if a calculative orientation were 'permitted'").

abstraction (and, thus, obscuration and obfuscation).[275] Actors that engage in signaling trust and trustworthiness want something from each other. If I want something from another human being—as an independent, autonomous actor whose actions and inactions I do not control—I will engage in a calculative exercise to find out about and achieve two ends: (i) how to get it and (ii) what to give for it. Not "getting" or not "giving" is no longer part of the calculative equation.[276] Although trust matters,[277] trust only matters because it pays.[278]

275. *Cf.* Luhmann, *Familiarity*, *supra* note 51, at 98 ("Moreover, trust is only possible in a situation where the possible damage may be greater than the advantage you seek. Otherwise, it would simply be a question of rational calculation and you would choose your action anyway, because the risks remain within acceptable limits. Trust is only required if a bad outcome would make you regret your action.") (reference omitted). *Cf. also* Lee, *supra* note 10, at 537.

276. *Cf.* ARROW, *supra* note 28, at 23 ("Trust is … extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word. Unfortunately this is not a commodity which can be bought very easily. If you have to buy it, you already have some doubts about what you've bought."). My point is that we should extend this Arrowian insight to the very basis of trust. Trust is 'bought' or 'contracted' for. Trust constitutes an implicit, gap-filling, self-enforcing 'contract' because to provide for details ex ante by complete contracting is just "too damn hard." Trust is a commodity, only on perhaps a higher plain of complexity, and we should have doubts about what it is that we are buying and for what ends we are willing to engage in these forms of subtle manipulations of others and selves. *See also* Williamson, *Calculativeness*, *supra* note 85, at 486 n.136 ("When trust is justified by expectations of positive reciprocal consequences, it is simply another version of economic exchange.") (quoting JAMES MARCH & JOHAN OLSEN, REDISCOVERING INSTITUTIONS 27 (1989)).

277. *Cf.* Ben-Ner & Putterman, *supra* note 196, at 523 ("The need to decide whether to trust another party is ubiquitous in business dealings."); Chapman, *supra* note 183, at 549 ("Trust plays an essential role in all modern economies, and without it, or without the coordination that is provided by institutional loyalty, even efficient wealth-maximizing corporate contracting can make us all worse off."); Coffee, *supra* note 177, at 2175; Dent, *Race*, *supra* note 212, at 1001-02; Hill & O'Hara, *supra* note 258, at 1723 ("Trust is an essential component of human relationships and a fundamental building block of healthy societies."); Mitchell, *Fairness*, *supra* note 196, at 425 ("Trust is the glue that binds corporate relationships."); Mitchell, *Trust*, *supra* note 23, at 185 ("Trust is one of the most important institutions binding our society."); Stout, *Investor Confidence*, *supra* note 51, at 408 ("Investor trust provides the foundation on which the American securities market has been built. Without investor trust, our market would be a thin shadow of its present self.").

278. "The service and the loyalty I owe, In doing it, pays itself." WILLIAM SHAKESPEARE, MACBETH act 1 sc. 4. *See supra* note 187 and accompanying text. *See also* Ribstein, *Law v. Trust*, *supra* note 227, at 553 ("Trust is a kind of social glue that allows people to interact at low transactions costs.") (footnote omitted).

Trust is only about using each other to maximize one's own individual utility.[279] Trust pays[280] because—as a calculative, mutually reciprocated, self-enforcing and, thus, autopoietic means designed to deal with uncertainty once complete contracting becomes impossible or, at least, impracticable[281]—it allows trust parties to achieve their respective individual, egocentric ends. When trust works well, those individual ends turn out to be fully complementary. At the same time, a successful trust arrangement reinforces the calculative exercise of trusting as both individually and mutually beneficial.[282] Given such reality of trust relationships, it is not "calculative trust," but its opposite, noncalculative trust, that is truly oxymoronic, *i.e.*, "a contradiction in terms."[283]

Thus, trust is not a norm, but rather a calculative, manipulative[284] device of controlling the behavior of others (as well as of controlling the

279. *Cf.* Ribstein, *Law v. Trust*, *supra* note 227, at 560.

280. And *repays*; *see* Cooter & Eisenberg, *supra* note 61, at 1728.

281. *Cf.* Dent, *Race*, *supra* note 212, at 1003; Gambetta, *supra* note 85, at 218 ("If we were blessed with an unlimited computational ability to map out all possible contingencies in enforceable contracts, trust would not be a problem.") (reference omitted); Richter, *supra* note 5, at 174-75 ("Under Knighian uncertainty, it is impossible to write a complete contract that details all possible future contingencies, even if transaction costs are zero.") (footnote omitted).

282. Burke & Stets, *supra* note 26, at 348 ("When another person verifies one's self-view, the process of trust is activated. The self begins to see the other as predictable and dependable, and responds by developing trust in, and dependence on, the other. If the other responds benevolently (is trustworthy), then commitment to the relationship is fostered.") (reference omitted).

283. *Cf.* Williamson, *Calculativeness*, *supra* note 85, at 463; *id.* at 479 (explaining how the suppression of calculativeness itself may be calculative, thereby making it impossible to ever achieve pure non-calculative trust). In other words, trust only exists conditionally. It is always conditioned on at least *some* reciprocation (i.e., *some* manipulated reaction) by the trustee to the trusting behavior of the truster. Thus, 'unconditional trust' (*cf.* Luhmann, *Familiarity*, *supra* note 51, at 94) is similarly oxymoronic or a contradiction in terms. *Compare* Ribstein, *Law v. Trust*, *supra* note 227, at 556-57 ("Like one who trusts, one who is trustworthy in the sense discussed in this article behaves non-calculatively, and honors his promise even in the absence of constraints such as repeat dealings.") (footnote omitted). *See also* Ben-Ner & Putterman, *supra* note 196, at 525 ("[W]e suggest that the phenomenon of trusting in commerce is nonetheless substantially amenable to analysis in terms of self-interested calculation."); Hill & O'Hara, *supra* note 258, at 1727 ("[I]t becomes in practice quite difficult to separate out calculative from noncalculative trust-relevant behavior.").

284. *See* Stout, *Investor Confidence*, *supra* note 51, at 437 ("Experienced policymakers and businesspeople (and certainly experienced con artists) have long known that trust is a potent force in explaining and manipulating investor behavior.").

requiting behavior of oneself measured in units of trustworthiness). Trust is a pure hedge to control for future outcomes in a world of uncertainty[285]—for what is supposed to happen in order to make oneself individually (and individually only) better off. However, if trust is only a procedural device without normative substance other than in its mechanical application,[286] then it may be that most, if not all, of the other extralegal "norms" listed above are also mere calculative devices in order to predict, and manipulate, uncertain future behavior of (economic) actors, including oneself. In this regard, those protolegal variables rather become (or, more precisely, harbor hidden) protonormative variables. They are empty[287] enforcers of an *a priori* normative substance that (re)creates itself through autopoiesis. Without their embedded protonormative substance, the above "norms" are normatively vacuous.

In summary, legal and economic scholarship has begun to describe and narrate the phenomenon of normative reactions of directorial decisionmakers. However, we are far from explaining such phenomenon *per se* (*i.e.*, from normatively explaining why it happens, such that the genius of our American corporate law[288] has stayed away from any enforceable *ex-post* legal accountability or any *ex-ante* legal constraints in order to deter or punish directorial shirking).[289]

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285. *Cf.* Mitchell, *Trust*, *supra* note 23, at 191.

286. *Cf.* Dent, *Race*, *supra* note 212, at 1001-02 ("Trust in others is essential to human interaction, especially in dealings too complex for the parties' rights and duties to be detailed in writing."). Thus, trust is a similar device to a 'contract' and comes with the identical functionality of a 'contract' and with nothing of normative value beyond such functionality.

287. In other words: prescriptively neutral.

288. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1, 151 (1993); McChesney, *supra* note 13, at 256. *See also* Roberta Romano, *Competition for State Corporate Law*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 364-69 (2002). *Cf.* BAINBRIDGE, *supra* note 1, at 3. Even though the reference is to American corporate law, it is often claimed, as part of the so-called "convergence debate," that such genius of American corporate law is more and more universally accepted. *See, e.g.*, Bainbridge, *Director v. Shareholder Primacy*, *supra* note 3, at 45; Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 439, 468 (2001).

289. *Cf.* Gambetta, *supra* note 85, at 217 ("But 'why should beliefs held by different individuals (or types of individual) be commonly known? The fact is that our understanding of human psychology … is hopelessly imperfect. In particular, we have little idea of how individuals actually acquire beliefs'. Among these beliefs, trust – a particular expectation we have with regard to the likely behaviour of others – is of fundamental importance.") (quoting from Kenneth Binmore & Partha Dasgupta, *Game Theory: A*

VI. CLOSING SKETCHES: UNCOMMANDED COMMAND WITHOUT PRINCIPLE?

This Article elaborated on a dilemma under the *absolute director primacy model* that I have developed[290] and concludes that the dilemma is more complex and abstract than originally expected. The dilemma is simply this: the board of directors in a Berle-Means corporation is not only autocratic, but it can also be totalitarian if, when and where it so pleases.[291] Directors have complete discretion to make corporate decisions by fiat and without any legal accountability for the substance of their decisions (as long as there is no implication of self-interest raising duty of loyalty concerns). Directorial behavior based on unrestricted power is, therefore, by definition completely opportunistic.

No rational investor would participate in a firm knowing that its central decisionmaker can always act opportunistically (and, thus, shirk on performance at random) and, nonetheless, always get away with it. However, the empirically observable average of directorial behavior

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Survey, *in* ECONOMIC ORGANIZATION OF GAMES (Kenneth Binmore & Partha Dasgupta eds. 1986)); Langevoort, *supra* note 12, at 832 ("Until we discover exactly what directors hear amidst all the noise, we cannot begin to evaluate the wisdom of our bundle of legal and regulatory strategies touching on questions of boards of directors' responsibilities."); Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955, 2026 (2001) ("We are still, unfortunately, extremely far from formulating a general, predictive and falsifiable theory of norms."); Williamson, *supra* note 147, at 596 ("[W]e are still very ignorant about institutions.").

290. Reich-Graefe, *supra* note 10.

291. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1791 ("The net result is that, as a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting than she is to pay damages."); Jones, *supra* note 15, at 117 ("Independent directors face an infinitesimal risk of paying personally for damages to the corporation cause bye their breach of fiduciary duty."); Mitchell, *Trust*, *supra* note 23, at 190 (stating that "directors have largely unlimited power over the corporation and its affairs"); Stout, *Proper Motives*, *supra* note 12, at 6 ("The business judgment rule . . . allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability."); *id.* at 6-7 ("[I]t is only a slight exaggeration to suggest that a corporate director is statistically more likely to be attacked by killer bees than she is to have to ever pay damages for breach of the duty of care."). *See also* Alces, *supra* note 42, at 242 ("It is dangerous and costly to assume that fiduciary duties function well in the corporate context. The assumption may give shareholders a false sense of security or a belief that they are able to discipline management effectively when in fact, because of the very limited nature of corporate governance duties, they are not.").

suggests that corporate directors seem to get it reasonably right most of the time. Firm-specific investments are made—daily and literally millions of times over[292]—and with a good measure of predictive accuracy.

I posit that a sound theoretical explanation of this phenomenon (and dilemma) is still missing from our current corporate governance debate. Neither current corporate law nor our microtheoretical models of the firm[293] do (or, logically, can) explain the daily phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment*[294]—other than to assume ultimate control by some firm participant's interests (for example, shareholder value), which is entirely illusory.[295] We really have no good idea yet about how corporate directors, faced with limitless opportunities (at least, in principle), will select from a complete set of nonreviewable substantive options that are available to them pursuant to their absolute, *sui generis* decisionmaking power granted by corporate law. Neither do we have a good idea yet about how corporate directors are incentivized to repeated-

292. For example, the average daily trading volume on the New York Stock Exchange for NYSE-listed companies in 2009 totaled 7,982,926 trading transactions *per diem*, comprising an average of 2,179,775,581 shares traded for a total average consideration of $46,670,638,331. *Facts & Figures: Interactive Viewer*, NYSEDATA.COM, http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=3002&category=3). *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1737.

293. The main four models in today's academic discussion can be labeled as "shareholder primacy," "contractarian," "team production" and "director primacy." *See*, *e.g.*, Bainbridge, *Director v. Shareholder Primacy*, *supra* note 3 (discussing shareholder-primacy and director-primacy models); Coates, *supra* note 10 (discussing team-production models); Dent, *supra* note 10 (discussing team-production and director-primacy models); Fisch, *supra* note 10 (discussing shareholder-primacy models); Lee, *supra* note 10 (discussing shareholder primacy and team production models); Reich-Graefe, *supra* note 10 (discussing all four models); Verret, *supra* note 10, at 315-26 (discussing all four models as well as "agency theory" and "progressive corporate law theory"). For a more general discussion of those firm models, *see also* Eisenberg, *supra* note 10; O'Kelley, *The Entrepreneur*, *supra* note 3; Wallman, *Understanding*, *supra* note 10.

294. *Cf.* Mitchell, *Trust*, *supra* note 23, at 191 ("Why would anybody invest money in a corporation, an institution over which she has no control?"); Stout, *Proper Motives*, *supra* note 12, at 3, 8 (asking why directors "seem to mostly live up to our trust"); *id.* at 9 ("Rational investors would never cede control of tens of trillions of dollars of assets to purely self-interested boards, given the tissue-paper thin protection offered by the rules of fiduciary duty, and the limits of social sanctions.").

295. *Cf.* Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 274 (1991).

ly select available options "properly" and "do the right thing."[296] Maybe Saint-Exupéry's advice is indeed true and the essentials do remain "invisible to the eyes."[297]

My attempt at an elaboration of the dilemma under the *absolute director primacy model* that is the focal point of this Article (and, thus, my attempt at more visibility and less "blackness" in the current corporate decisionmaking black box described above) has focused on directorial moral behavior—the dialectic confrontation of a limitless range of opportunities in the reality of corporate practice with normative directorial preferences. I argue that normative directorial preferences are controlled by "protolegal variables." Those variables constitute all forms of socio-contextual,[298] behavior-oriented and reciprocal[299] normative implications and foundations of interpersonal cooperation that are not enforceable at law, but that are, similar to legal imperatives, based on the interplay of expectations and counter-expectations that underlies social and private-party ordering.[300]

I posit that a theory of protonormative calculativeness (which utilizes the directorial moral psychology as a set of internalized calculative devices rather than a set of internalized moral norms) may help explain the requiting stability and cohesion of the corporate venture that is the

296. *Cf.* Grossman, *supra* note 53, at 465-66; Rock & Wachter, *supra* note 9, at 1608; Stout, *Proper Motives*, *supra* note 12, at 9. *See also* Meurer, *supra* note 53, at 740 (stating with regard to the problem of unforeseeable contingencies in transaction-cost-theory 'contracting' that "this begs the questions of how a firm gets managers to be pure profit maximizers").

297. ANTOINE DE SAINT-EXUPÉRY, *supra* note 246, at 63.

298. Stout, *Proper Motives*, *supra* note 12, at 13.

299. Fehr & Gächter, *supra* note 49, at 159 ("Reciprocity means that in response to friendly actions, people are frequently much nicer and much more cooperative than predicted by the self-interest model; conversely, in response to hostile actions they are frequently much more nasty and even brutal.").

300. LUHMANN, LOVE, *supra* note 51; LUHMANN, RISK *supra* note 51; LUHMANN, SOCIAL SYSTEMS, *supra* note 51; LUHMANN, TRUST AND POWER, *supra* note 51; Luhmann, *Familiarity*, *supra* note 51, at 97 ("You cannot live without forming expectations with respect to contingent events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a very rare possibility, but also because you do not know what else to do. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them."). *See also* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1796; Miller, *supra* note 51, at 641; Mitchell, *Trust*, *supra* note 23, at 191; Stout, *Investor Confidence*, *supra* note 51, at 410-15.

result of a (real or imagined) reduction of the systemic risk which firm participants' sunk investments otherwise logically face at the hands of "uncommanded commanders," namely corporate directors with absolute decisional primacy. In my view, such protonormative calculativeness is double-blind. Calculativeness exists, but normative actors, such as corporate directors, are unaware that it exists. Indeed, I argue that they *must not* be aware of it. They must obscure and obfuscate calculativeness at all cost.[301] Normative actors must be unable to perceive themselves as "calculative actors" and must rather deceive and view themselves as "good moral actors." Only in this way can preferences solidify and prevail over opportunities with some predictive accuracy (instead of the other way around, which, of course, creates our core agency cost problem and dilemma in corporate governance). I argue that such directorial behavioral preferences, however, only solidify if the normative actors blind themselves (*i.e.*, deceive themselves) and reciprocally reinforce their calculative blindness (for example, through the use of the trust "mechanism" as discussed above). Were normative actors to become aware of their manipulative reality of obscured, blinded calculativeness (*i.e.*, by confronting themselves with its truth and their own normative hypocrisy), I posit that they would immediately and irrevocably destroy the essence of their calculative relationship[302] (given that it is

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301. *Cf.* Williamson, *Calculativeness*, *supra* note 85, at 479 (explaining how the suppression of calculativeness itself may be calculative, thereby making it impossible to ever achieve pure non-calculative trust).

302. *Cf.* Blair & Stout, *Trustworthiness*, *supra* note 5, at 1797 ("Conversely, trying to shore up trust behavior by making it easier for corporate participants to 'litigate trust' may produce the counterintuitive result of an increase in the incidence of the untrustworthy behavior."); *id.* at 1808-09; Dent, *Race*, *supra* note 212, at 1004; Gambetta, *supra* note 85, at 213-14 ("The unqualified claim that more cooperation than we normally get would be desirable . . . , if preached too extensively, may even have the effect of making cooperation less attractive.") (footnote and reference omitted); Hill & O'Hara, *supra* note 258, at 1793 ("We think that the window of actual liability for breaches of the duty of care should remain small. A larger window might encourage costly and inefficient levels of residual distrust, where directors are overly motivated to 'look for everything' and officers, feeling distrusted, are more apt to behave in an untrustworthy manner.") (footnote omitted); Jones, *supra* note 15, at 109 ("[T]he prospect of disproportionate penalties hinder the internalization of appropriate moral values by corporate leaders."); Langevoort, *supra* note 12, at 831 ("When the law becomes too aggressive, it risks altering the social dynamic of the board in a way that makes it less effective as a working group."); Mitchell, *Trusted*, *supra* note 13, at 606; (describing that Oliver E. Williamson's economic model of trust may make the point that personal trust only aris-

a fake) and with it, of course, the predictive utility of their calculativeness.[303]

Therefore, protonormative, double-blind calculativeness appears to be the only visible explanation, to date, of the phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment*. For the time being, it appears to constitute the only visible, though tentative backstop—thus, the only *principle*—against abuses of directorial discretion under absolute decisionmaking primacy, which abuses remain non-approbated in the legal, market and social contexts. I made the point in my opening sketches above that something like "hope" (*i.e.*, a "morally rational" expectation extended by firm participants to directors that the latter will use their respective moral compasses and will get it "right" more often than not and protect and increase the former's investment in the firm) does not appear to be something that we can and should accept as a satisfactory explanation and basis for the daily phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment*.[304] Further inquiry into this phenomenon may show that hope—more precisely, *double-blind calculative hope*—may be all there is to explain the phenomenon.

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es in very special and limited occasions in which the existence and awareness of calculativeness and monitoring would destroy such special trust relationship); Stout, *Proper Motives*, *supra* note 12, at 18 (evaluating empirical studies of altruistic behavior derived from experimental games called 'social dilemmas' and stating that "empirical evidence suggests that if we place too heavy a burden on such altruistic motivations, they will crumble under the weight").

303. And, arguably, reciprocity may then often result in brutal opportunism of corporate actors. *Cf.* Fehr & Gächter, *supra* note 49, at 159 ("Reciprocity means that in response to friendly actions, people are frequently much nicer and much more cooperative than predicted by the self-interest model; conversely, in response to hostile actions they are frequently much more nasty and even brutal.").

304. *Cf.* Stout, *Proper Motives*, *supra* note 12, at 3, 8 (asking why directors "seem to mostly live up to our trust"); *id.* at 9 ("Rational investors would never cede control of tens of trillions of dollars of assets to purely self-interested boards, given the tissue-paper thin protection offered by the rules of fiduciary duty, and the limits of social sanctions.").