Deconstructing Corporate Governance: Director Primacy Without Principle?

René Reich-Graefe*
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Abstract

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KEYWORDS: Corporate Law, Director Primacy

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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”† within the field. Since Adolf Berle and Gardiner Means’ *The Modern Corporation and Private Property,*‡ 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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ship) as the “master problem for research.” 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.


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]


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.


and have been successful at developing a good number of insightful and valuable microtheoretical\textsuperscript{9} models of the firm\textsuperscript{10} but, as I have analyzed

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.

\textit{Id.} (emphasis added). \textit{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. \textit{Live} the questions now. Perhaps you will then gradually, without noticing it, live along some distant day into the answer.”).

\textsuperscript{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. \textit{Cf.} William T. Allen, \textit{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, \textit{Norms & Corporate Law: Introduction}, 149 U. PA. L. REV. 1607, 1608 (2001).

in more detail elsewhere,\textsuperscript{11} we are still a significant distance away from fully explaining “the wisdom” that Berle and Means so thoroughly and masterfully “blundered into.”\textsuperscript{12} Measured by the predictive ability and accuracy of such models\textsuperscript{13} (i.e., their respective ability to predict...
both investor and manager behavior subject to an ambient mix of motives, incentives, aspirational legal mandates\textsuperscript{14} and market forces\textsuperscript{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”\textsuperscript{16} that

\textsuperscript{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).


\textsuperscript{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”—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, 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. 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 and its decisionmaking authority to run the corporation’s business and affairs as it sees fit is absolute, original, infinite and, thus, sui generis (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.


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, ipso 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”). 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.

CORPORATE LAW 185, 190 (Lawrence E. Mitchell ed., 1995) [hereinafter Mitchell,
Trust] (“The power and control that are present in all fiduciary relationships is exagger-
ated in the corporation where the indeterminate length of the enterprise and the practi-
cally infinite array of investment opportunities for the corporation make any possibility
of specified limitations on directors’ power or ongoing control by the stockholders un-
realistic.”).

24. Sui generis decisionmaking authority of corporate directors means that their
decisionmaking power is non-derivative. In particular, shareholder primacy models in-
correctly 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 establish-
ment 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 cen-
tury, 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 stockholders.’”) (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. Bain-
bridge, The Case for Limited Shareholder Voting Rights, 53 UCLA L. REV. 601 (2006);
Bainbridge, Competing Concepts, supra note 13; Stephen M. Bainbridge, Director Pri-
mary 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-

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. 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.

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. Not only should such a system allocate authority and discretion for making adaptive decisions on behalf of the firm, it should also define, if possible, the norms and interests that should guide the internal decisionmakers in their decisionmaking. Otherwise, any exercise of deci-


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. However, 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. 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. Therefore, I argue that we need to consider model-transcending protolegal variables (for example, any applicable moral obligations) and explain their external, exogenous influence over current microtheoretical models of the firm 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.
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: 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. 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 or aspirational—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. Inevitably,

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 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.”).


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. 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 reciprocal49 variables50 based on pre-coded expectations and counter-expectations and aimed at reducing social complexity51) that directors know what they do, that they have int-

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).

ternalized the correct moral compass, and, thus, using such compass, will “do the right thing” more often than not. 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. The inquiry thus becomes: if profit-maximizing is not enforced by corporate law, why does it nonetheless happen as a matter of almost overwhelming routine in today’s corporate reality? 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].


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 “why 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 Stout, The Mythical Benefits of Shareholder Control]).
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?”).


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

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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: monitoring66 and bonding67 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 governance70 is not simply residual, it is center-stage, abso-

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.
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 & Wachtler, 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).”
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

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. 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*). 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. We can observe and explain why it is

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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 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*. From all we can tell, these investments are made—daily and literally millions of times over, and with a good measure of predictive accuracy. Therefore, something currently left unexplained must allow for investor confidence and economic efficiency *ex-ante*. 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*.

This “something” I call “protolegal variables.” With this admittedly open-ended and diffuse label, I try to distill into one category all those socio-contextual, behavior-oriented and reciprocal normative implications and foundations of interpersonal cooperation which are based on expectations and counter-expectations. 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.”).


85. *See* Oliver E. Williamson, Calcuttiveness, Trust and Economic Organization, 36 J.L. & Econ. 453, 469 (1993) [hereinafter Williamson, Calcuttiveness] (“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.”).


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 above91 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\textsuperscript{92} and, in particular, how they are incentivized to repeatedly select “properly” and to “do the right thing.”\textsuperscript{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 \textit{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.\textsuperscript{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,

\textsuperscript{92} Cf. Mitchell, \textit{Trust}, supra note 23.

\textsuperscript{93} Cf. Grossman, \textit{supra} note 53, at 465-66; Rock & Wachter, \textit{supra} note 9, at 1608; Stout, \textit{Proper Motives}, \textit{supra} note 12, at 9. \textit{See also} Meurer, \textit{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”).

\textsuperscript{94} Note again that \textit{protolegal} variables may turn out to be “observable, but not verifiable.” Cf. Hart, \textit{Norms and Theory}, \textit{supra} note 38, at 1702; Rock & Wachter, \textit{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 macrotheoretical 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 firm⁹⁵ 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 wealth¹⁰¹—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-

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-spend—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 decisionmaking106 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:

- Aristotelian notions of rectification (corrective justice) and
fairness (distributive justice); 108

- market liberalism (private liberty) and utilitarianism (social utility); 109

- 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.


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.”).

First, the firm can be seen as merely a result of private-party initiative and market competition. Accordingly, corporate law, as the enabling framework 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. 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.” In other words, market forces control.

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


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 commutative129 or interactive130) 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.,

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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’).


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.


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


130. Wright, supra note 108, at 1883.

their breach resonates in tort, not in contract). The basic idea is that parties to bipolar relations have an original, notional equality relative to their transactions/interactions with each other. 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. Thus, corrective justice is about the restoration of the parties’ original equality relative to their transaction/interaction.

Distributive justice applies to multipolar relations. 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. The main concern is fair allocation and distribution of resources and wealth. In Aristotelean terms, each party shall receive according to her due. Thus, the relative merit of each party in a multipolar relationship (i.e., their proportional equality) matters. 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

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


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\(^\text{144}\) and deals with the transfer or administration of what economists call “private goods.”\(^\text{145}\) Those goods (e.g., a contract) are seen as the result of individual action.\(^\text{146}\) 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.”\(^\text{147}\) Contrastingly, NIEH concentrates on the “formal and informal institutional constraints which control the behavior of more than two actors.”\(^\text{148}\) Its focus is the provision or administration of what economists call “public goods.”\(^\text{149}\) Such goods (e.g., a corporation) are the result of collective action.\(^\text{150}\) 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.”\(^\text{151}\) Protolegal variables thus impact (if not control, as argued under the absolute director primacy mod-

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\(^\text{145}\) Richter, supra note 5, at 178.

\(^\text{146}\) Id.

\(^\text{147}\) Id.

\(^\text{148}\) 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”).


\(^\text{150}\) Richter, supra note 5, at 178.

\(^\text{151}\) 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.


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.


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.

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

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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.
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.” Indeed, “[a]ll economic activity must necessarily involve a step, however small, toward the exhaustion of available energy.” Thus, “[i]nfinite growth in a finite environment is an obvious impossibility.”

Against this backdrop, shareholder wealth can no longer be equated with social welfare—nor can firm value any longer be equated with social value. 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.). The greater the concentration of economic power of a firm, in particular in the form of the modern Berle-

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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).


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 pursuing 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.

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

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, 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. This is where things inevitably become slippery 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.

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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).
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
Pursuant to the *absolute director primacy model*, directorial decisionmaking power is absolute. 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 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.”

opportunities. 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” realm of (supposedly) “ugly”
normative research. However, norms do matter. 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. Not only then, do directors have preferences to adhere to normative standards, but their preferences affect aggregate behavior in equilibrium. 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.

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

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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\textsuperscript{182} since “we are blissfully in Nash equilibrium.”\textsuperscript{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 (\textit{i.e.}, making decisions in good faith and the reasonable belief that they are in the best interest of the corporation).\textsuperscript{184} In other words, corporate directors are “good”\textsuperscript{185} \textit{Macbeths} whose fiduciary obligation is entirely self-enforcing.\textsuperscript{186}

\begin{quote}
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.\textsuperscript{187}
\end{quote}

\footnotesize
\begin{itemize}
\item 182. \textit{Cf.} Langevoort, \textit{supra} note 12, at 800 (“[T]he law played a relatively minor role in the evolution of board structure and behavior . . . .”); Robert B. Thompson, \textit{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.”). \textit{See also} Gilson, \textit{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, \textit{supra} note 118 (“Law has its limits.”); \textit{id.} at 165 (“Perhaps the best corporate law is no law at all.”).

\item 183. Bruce Chapman, \textit{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/payoff through unilateral changes in her chosen game strategy. \textit{id.} at 586 n.74.

\item 184. \textit{See} Cooter & Eisenberg, \textit{supra} note 61, at 1723. \textit{See also} Cooter, \textit{supra} note 149, at 1661-63; Mitchell, \textit{Norms, supra} note 149, at 197.

\item 185. I am talking about the beginning of Shakespeare’s \textit{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” (\textit{i.e.}, as the husband of the goddess of war and as apparently already having replaced Mars, the god of war).

\item 186. \textit{Cf.} Mitchell, \textit{Trusted, supra} note 13, at 614.

\item 187. \textit{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—both in the economic literature on norms in organizations (usually rubricated under the heading of “self-enforcing” or “self-governing” contracts), 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).

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 and trustworthiness,

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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.


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 constituents. 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\textsuperscript{193} and faithfulness;\textsuperscript{194}
• loyalty;\textsuperscript{195}
• fairness;\textsuperscript{196}
• guardianship\textsuperscript{197} and duty;\textsuperscript{198}
• sense of honor;\textsuperscript{199}
• sense of obligation\textsuperscript{200} and responsibility;\textsuperscript{201}
• honesty (truthfulness)\textsuperscript{202} and integrity;\textsuperscript{203}
• confidence;\textsuperscript{204}
• (moral) character\textsuperscript{205} and decency;\textsuperscript{206}

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


195. Mitchell, \textit{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).


204. Alces, supra note 42, at 241; O’Kelley, \textit{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, \textit{Trusted}, supra note 13, at
• reputation,207 prestige208 and credibility;209
corporate culture;210
generosity211 and altruism;212 and
affinity213 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-

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; Elhaug, 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 syn-
onyms may be used for this “norm” including “being, core, . . . ethos, identity, ideology,
manner, patterns, philosophy, purpose, roots, spirit, style, vision, and way.” STANLEY
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, Al-
truism 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).
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 per-
formance 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 spectrum219 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-

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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.
behavior) 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 appropriate223).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?”)).


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\textsuperscript{225} to others that a particular normative agenda is at play and controlling the decisionmaking—whether that is indeed the case or not).\textsuperscript{226} In the latter variant, where the normative directorial footprint becomes part of the firm’s social capital,\textsuperscript{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)\textsuperscript{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 \textit{ex-post} social sanctions (as opposed to non-existent legal sanctions), such as guilt, disapprobation and other shaming exercises\textsuperscript{229} that, in the case of noncompliance with norms, would lead to reputational net losses\textsuperscript{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).\textsuperscript{231} Fear of shaming

\textsuperscript{225} Cf. Gambetta, \textit{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).

\textsuperscript{226} See, e.g., Coffee, \textit{supra} note 177, at 2152; Cooter & Eisenberg, \textit{supra} note 61, at 1722; Mitchell, \textit{Trusted}, \textit{supra} note 13, at 597. See also Lee, \textit{supra} note 10, at 572 (“People act morally because their utility responds to ‘social and moral sanctions.’”).


\textsuperscript{228} Cooter & Eisenberg, \textit{supra} note 61, at 1719.


\textsuperscript{230} See, e.g., Rock & Wachter, \textit{supra} note 60, at 430.

\textsuperscript{231} See, e.g., Jones, \textit{supra} note 15, at 108; Meurer, \textit{supra} note 53, at 744 (“Reputation works in the larger commercial community to promote efficient performance.”); Stout, \textit{Proper Motives}, \textit{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.\footnote{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).\footnote{233} This realm is not about external incentives or pressures influencing directorial decisionmaking.\footnote{234} It is about neither sticks nor carrots, but about internal pressures that may be prevalent in a given director’s moral psychology\footnote{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”\footnote{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.\footnote{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-
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.\textsuperscript{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.\textsuperscript{239} Therefore, this second realm of norm actuation is less dependent on \textit{ex-post} external sanctions (social or legal). Rather, it emphasizes \textit{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).\textsuperscript{240}

How and when such \textit{ex-ante} internalization within the second realm of norm actuation comes about, however, is extremely difficult to ascertain.\textsuperscript{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.\textsuperscript{242} Finally, and perhaps most importantly, we need to find out how such internalized

\textsuperscript{238.} Cf. Chapman, \textit{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 \textit{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, \textit{Breach of Trust in Hostile Takeovers, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES} 33 (A. Auerbach ed., 1988)); Grossman, \textit{supra} note 53, at 466 (“Perhaps a better approach is to make directors \textit{want} to do the right thing.”) (emphasis in original); Ribstein, \textit{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.”).

\textsuperscript{239.} Cf. Mitchell, \textit{Trusted, supra} note 13, at 612.

\textsuperscript{240.} Cf. Burke & Stets, \textit{supra} note 26, at 347; Elhauge, \textit{supra} note 35, at 752 (“pleasurable feelings of virtue, inner peace, or satisfaction”).

\textsuperscript{241.} Cooter & Eisenberg, \textit{supra} note 61, at 1728.

\textsuperscript{242.} Gambetta, \textit{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 \textit{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. 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. A Taoist or mysticism-based approach to the accountability

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 “homsocial 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 “homsocial 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.


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. Much has been written about trust, the central “extra-legal” norm of directorial behavior. For example, Lawrence Mitchell, one of the leading legal scholars on trust and trustworthiness in the realm of corporate law, 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. Moreover, Oliver Williamson, in his leading economic model of trust, has famously stated that “calculative trust is a contradiction in terms” 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. 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. For Mitchell, extralegal norms like trust are part and parcel of all human relations (including those of economic, rational-choice actors),
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.”

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.

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). 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. However, I am uncertain whether the expectational 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 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.
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
In other words, I believe that, in contrast to the Williamsonian worldview in which “[c]alculative trust is a contradiction in terms,”

calculative trust is rather a generally misunderstood tautology. Trust and trustworthiness are always calculative. They are designed to deal with the eternally present Knightian uncertainty of future outcomes.

trust is a potent force in explaining and manipulating investor behavior.” (emphais 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 trusted, 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. They are self-referential, autopoietic expectation exercises that always work both ways and lock both parties into a cohesive, dyadic, and requiting dance. Why do we do this? Because it, apparently, is too hard for us human beings in post-capitalist industrial societies to each be (or to, at least, try to be as much as humanly possible) individually autonomous, authentic and true to ourselves.

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.


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.\textsuperscript{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.\textsuperscript{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 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.

\textsuperscript{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). \textit{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.”); \textit{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.”).

\textsuperscript{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).\textsuperscript{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.\textsuperscript{276} Although trust matters,\textsuperscript{277} trust only matters because it pays.\textsuperscript{278}

\begin{itemize}
  \item \textsuperscript{275} Cf. Luhmann, \textit{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.
  \item \textsuperscript{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. \textit{See also} Williamson, \textit{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)).
  \item \textsuperscript{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, \textit{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, \textit{supra} note 177, at 2175; Dent, \textit{Race}, \textit{supra} note 212, at 1001-02; Hill & O’Hara, \textit{supra} note 258, at 1723 (“Trust is an essential component of human relationships and a fundamental building block of healthy societies.”); Mitchell, \textit{Fairness}, \textit{supra} note 196, at 425 (“Trust is the glue that binds corporate relationships.”); Mitchell, \textit{Trust, supra} note 23, at 185 (“Trust is one of the most important institutions binding our society.”); Stout, \textit{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.”).
  \item \textsuperscript{278} “The service and the loyalty I owe, In doing it, pays itself.” \textsc{William Shakespeare}, \textit{Macbeth} act 1 sc. 4. \textit{See supra} note 187 and accompanying text. \textit{See also} Ribstein, \textit{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).
\end{itemize}
Trust is only about using each other to maximize one’s own individual utility. Trust pays 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—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. 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.”

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

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 Knightian 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 trustee. 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 extra-legal “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).\(^ {289}\)


\(^{286}\). 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 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. 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 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 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—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 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—other than to assume ultimate control by some firm participant’s interests (for example, shareholder value), which is entirely illusory. 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-


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.”).

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 reciprocal299 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.


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 relationship302 (given that it is

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.\textsuperscript{303}

Therefore, protonormative, double-blind calculativeness appears to be the only visible explanation, to date, of the phenomenon of general investor confidence \emph{ex-ante-investment} in the face of absent director accountability \emph{ex-post-investment}. For the time being, it appears to constitute the only visible, though tentative backstop—thus, the only \textit{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” (\textit{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 \emph{ex-ante-investment} in the face of absent director accountability \emph{ex-post-investment}.\textsuperscript{304} Further inquiry into this phenomenon may show that hope—more precisely, \textit{double-blind calculative hope}—may be all there is to explain the phenomenon.

\begin{footnotes}
\item[303.] And, arguably, reciprocity may then often result in brutal opportunism of corporate actors. \textit{Cf.} Fehr & Gächter, \textit{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.").
\item[304.] \textit{Cf.} Stout, \textit{Proper Motives, supra} note 12, at 3, 8 (asking why directors “seem to mostly live up to our trust”); \textit{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.").
\end{footnotes}