THE ECONOMICS OF FIDUCIARY ACCOUNTABILITY

BY ROBERT FLANNIGAN*

ABSTRACT

From an economic perspective, conventional fiduciary liability for self-dealing appears to raise little controversy. The accepted function of the duty of loyalty is to control opportunism in limited access arrangements. That legal duty is complemented by a variety of economic mechanisms that indirectly or incidentally perform the same function. Unfortunately, the conventional function is partially obscured by a number of conceptual confusions in the economic and legal literature. A review of the literature exposes the analytical misdirection and confirms the utility of the conventional proscription on self-interest.

I. INTRODUCTION

The conventional function of fiduciary regulation is to control opportunism in limited access arrangements. That function has never been disputed. What has happened over time, however, is the unprincipled introduction into the fiduciary jurisdiction of other disconnected or dissimilar functions (e.g., reviewing discretion, assessing fairness). That process of accretion has proceeded for three decades in the general jurisprudence,[1] and for over a century in corporate law.[2] It is largely the consequence of conceptual and linguistic confusion. Commentators employing economic methodology have both contributed to, and been waylaid by, that confusion. Legal and economic analyses have compromised each other in a cascade of misdirection. Elsewhere I have examined the judicial authorities.[3] Here I investigate the efforts of commentators who take an economic approach to the analysis of fiduciary accountability. I conclude that the economic perspective, where it has traction, only replicates or confirms ancient principle, and otherwise does not imply alteration of the conventional position.

---

*Professor, College of Law, University of Saskatchewan. My thanks to Rick Bigwood, Matthew Conaglen and Dennis Klinck for their comments.

[1] *See* Robert Flannigan, *The Boundaries of Fiduciary Accountability*, 83 CAN. B. REV. 35 (2004).

[2] *See* Robert Flannigan, *The Adulteration of Fiduciary Doctrine in Corporate Law*, 122 L.Q. REV. 449 (2006).

[3] *See id.*; Flannigan, *supra* note 1; Robert Flannigan, *Fiduciary Duties of Shareholders and Directors*, 2004 J. BUS. L. 277.

It may be observed at the outset that economic analysis is one of a number of methodologies that might be employed to justify or challenge a particular kind of legal regulation. Like other methodologies, it is a conceptual platform that enables public policy to be openly brought to bear on questions that would otherwise be resolved by abstract legal reasoning that often conceals the policy subtext that underlies every datum of the law. In a broad sense, there are no "economic" arguments. There are just policy arguments. Thus, it is a policy assertion that opportunism is sufficiently controlled by various markets. There is nothing intrinsically "economic" about that argument, or, to put it another way, nothing turns on the fact of its economic character or presentation. It is simply a policy argument about how we might regulate opportunism. A competing policy argument is that markets are neither perfect nor personal and, therefore, do not satisfactorily check opportunism.[4] Those arguments and others are assessed to determine if and how, as a matter of public policy, we can fashion regulation to effectively pursue our objective of constraining opportunistic behavior. We could, at the same time, draw on other methodologies. We might, for example, simultaneously apply a public choice analysis to evaluate political considerations that may indicate that one form of regulation is superior to another, given the political environment. Or we might undertake a sociological analysis of behavior that examined the social capital and social pressures of the community. These methodologies serve only as conceptual packaging for arguments that may or may not usefully inform our policy conclusions about the regulation of opportunism. We find arguments where we can, and it is largely unimportant what methodology brings them to us. Their relative influence on an issue is determined by their specific worth in each instance.

II. OPPORTUNISM

It is initially necessary to distinguish the different contexts in which opportunism might operate. Context determines whether opportunism is actionable as a fiduciary breach, as some other kind of breach, or not actionable at all. The context for conventional fiduciary accountability is a limited access arrangement. When actors undertake to serve the interests of others, they acquire access to the assets and opportunities associated with the undertaking. That access may be exploited to serve their own interests. We recognize that mischief and seek to control it through the imposition of status or fact-based fiduciary accountability. Our regulation of this *production*

[4]On the limits of markets, see *infra* note 124.

opportunism is calculated to foster commitment to the limited purpose of the undertaking.[5]

Contrast production opportunism with *exchange opportunism*.[6] Whereas production opportunism is associated with the production process (trustees invest property, solicitors advise clients, parents raise children) and its penumbral reach,[7] exchange opportunism occurs at the exchange interface between production units. When actors initially agree to undertake production processes, they will negotiate the terms of their contribution. Those terms may require or permit actions by the parties that will subsequently affect the renegotiation of the contract, and they may find themselves in a position to extract concessions from each other when they return to the exchange interface. The standard example in the literature is a situation of asset specificity. The original contract may require one actor to invest in an asset that is highly specific to a particular relation, for example, equipment that is peculiarly suited to the production of a unique good or service. Once the equipment is engaged, it will be costly to re-task. That may permit the other party to exploit the asset specificity at the renegotiation stage and insist on a greater share of returns. Another example is an employee required to purchase highly specific tools. If costly, the negotiating position of the employer may benefit from a lock-in effect, and the employer may then decline to offer pay increases at the contract renewal stage. The effect, it will be appreciated, can operate in any direction. Agents, for example, may be required to invest in specialized skills in the course of their undertakings. Or they may develop unique specialized relations with buyers. In such cases, believing they have enhanced their bargaining power, agents may subsequently insist on a redistribution of returns in their favor. Alternatively, it may be that their principals believe the specialized skills or relations have their highest value in the current undertaking, and that the agent is therefore again subject to a degree of exploitable lock-in. These are all examples of "opportunistic" contracting.

---

[5]The term "production" is used here in its widest sense of shaping human or physical capital for any end. It includes, for example, the production of exchange, in the sense that some firms exist to create markets or to broker exchanges. All limited access arrangements involve the production of either a good or service. Production opportunism is then the opportunism that is latent within the scope of that arrangement.

[6]Robert Flannigan, *The Economic Structure of the Firm*, 33 OSGOODE HALL L.J. 105, 111-12 (1995).

[7]Penumbral reach extends, for example, to diversions of associated confidential information and to related opportunistic conduct prior or subsequent to the formal duration of a fiduciary obligation.

In the exchange context, however, this opportunism is not generally actionable.[8]

The difference between production and exchange opportunism is contextual.[9] In the case of exchange opportunism, the opportunism arises when the actors are *bargaining* the terms of their future relation. With production opportunism, the creation or renewal of the relation has already occurred, the relation is in some way a limited access arrangement, and the actor is acting inconsistently with the other-regarding purpose of that access. We treat the two contexts very differently. Production opportunism is strictly proscribed.[10] Exchange opportunism, on the other hand, is not generally proscribed. Rather, it is permitted—even *expected*. It is essentially only competitive behavior at the contract negotiation or renegotiation stage. As such, it is acceptable for all the reasons that competition is generally acceptable in market economies. Strategic considerations on both sides will invariably inform negotiations, but there will be no legal consequences for the opportunistic impulse as long as the parties remain within the applicable constraints on contract formation (e.g., capacity, duress, undue influence, unconscionability) and competitive behavior (competition rules).

---

[8]Actors often do anticipate this sort of opportunism (just as they anticipate production opportunism), and may take steps to address it. Vertical integration, for example, is one response to the prospect of opportunism where assets are highly specific. Or in the case of specialized skills or relations, the principal may initially negotiate a non-competition agreement that might lessen the risk of redistribution from specialization. With respect to vertical integration, see Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298 (1978):

> The crucial assumption . . . is that, as assets become more specific and more appropriable rents are created (and therefore the possible gains from opportunistic behavior increases), the costs of contracting will generally increase more than the costs of vertical integration. Hence, *ceteris paribus*, we are more likely to observe vertical integration.

See also Benjamin Klein, *Fisher—General Motors and the Nature of the Firm*, 43 J.L. & ECON. 105 (2000); Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444 (1996); Richard N. Langlois & Paul L. Robertson, *Explaining Vertical Integration: Lessons From the American Automobile Industry*, 49 J. ECON. HIST. 361 (1989); Scott E. Masten, *The Organization of Production: Evidence from the Aerospace Industry*, 27 J.L. & ECON. 403 (1984); Russell Pittman, *Specific Investments, Contracts and Opportunism: The Evolution of Railroad Sidetrack Agreements*, 34 J.L. & ECON. 565 (1991).

Demsetz questions the view that the capacity to mitigate opportunism is the main explanation of vertical integration. Other explanations include price controls, successive monopoly, transaction costs, economies in continuity of operations, and informational advantages accruing to managed direction of activities. *See* HAROLD DEMSETZ, THE ECONOMICS OF THE BUSINESS FIRM: SEVEN CRITICAL COMMENTARIES 15-39 (1997).

[9]The context may involve both production and exchange opportunism.

[10]Commentators have disputed the utility of the strict quality of fiduciary liability. *See* Robert Flannigan, *The Strict Character of Fiduciary Liability*, 2006 N.Z. L. REV. 209.

There is another expression of opportunism that appears to be of particular interest to economists.[11] It is the agency cost labeled "shirking."[12] The legal consequences of shirking vary depending on the nature and context of the behavior. Generally, shirking means reduced effort expenditure. In many instances, shirking is not legally actionable at all. For many tasks, there is a band of effort between maximal and minimal effort that remains contractually undefined and therefore subject to unilateral variation by the agent. That is, workers have a degree of latitude in the performance of their work. This band or range of discretionary effort typically exists because of information and monitoring weaknesses that prevent more precise specification and enforcement of effort levels. In some cases, it may even be explicitly negotiated (as a signaling or unilateral compensation adjustment mechanism). The breadth of this discretion can be narrow or wide.[13] Principals normally prefer that their agents operate at or near the maximal level. Agents may prefer to operate near the minimal level. Within any given band of effort, the equilibrium effort level will be determined by the commitment or enthusiasm of the agent as influenced by the incentives offered by the principal.[14] No level of effort actually adopted by the agent within the band will be actionable in any way. The negotiation has necessarily accommodated or permitted a degree of play in effort level. Within the band of discretion, shirking is just *performance*. There is no contractual breach. Nor, despite the self-interest of choosing low effort, is there a fiduciary breach. There is consent to all actual effort levels that exceed the minimal specification.

Shirking will at times be a fiduciary breach.[15] That is so where agents fabricate work arrangements or relations to take unauthorized benefits in the form of leisure or de facto pay increases. Such behavior is simply

---

[11] *See* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1432-33 (1985).

[12] Agency costs may be broadly defined as all the costs of using agents, with the term "agent" serving as a general label for actors performing any of a variety of functions (e.g., trustees, partners, directors, solicitors, employees, guardians, doctors, parents). A narrower definition of agency costs commonly employed by economists limits agency costs to the costs associated with the principal/agent problem (monitoring, bonding, welfare loss). *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure*, 3 J. FIN. ECON. 305, 308 (1976). In the narrow sense, agency costs are the costs of opportunism and the costs of controlling opportunism.

[13] Production lines, for example, tend to reduce the band of discretionary effort, while legal, financial or other advisory functions are generally associated with a wide band.

[14] *See* Joseph E. Stiglitz, *Incentives, Risk, and Information: Notes Towards a Theory of Hierarchy*, 6 BELL J. ECON. 552 (1975).

[15] Note that what may appear to be low effort may actually be the result of sabotage by another agent (e.g., at a bottleneck point) attempting to mask relative effort. In that instance, the sabotaging agent commits the fiduciary breach.

production opportunism. It is the same for low effort (less than minimal) in the form of demonstrable indolence. Pure indolence is just an unauthorized consumption of leisure. It is a self-interested expropriation of value by the agent. The fiduciary character of the breach is not changed or diminished because the objectionable conduct is "merely" sloth, or might be difficult to measure.[16] It may be added that indolence is often also concurrently a breach of contract (where there is a formal contract) and possibly a breach of care.

It is also necessary to distinguish opportunism (the duty of loyalty) from negligence (the duty of care). Some American commentators deny that there is a substantive distinction between the duty of loyalty and the duty of care.[17] That, however, is because their approach is not sufficiently developed.[18] Part of the difficulty is that they see only a seamless continuum from self-dealing through to shirking in the sense that both involve a conflict of interest.[19] That is a truncated analysis. The duty of care covers failures to exercise reasonable care in the performance of a task. While shirking may amount to negligence in a given case, that is because it independently offends the reasonable care standard. The duty of loyalty and the duty of care are distinct legal formulae that have a potentially concurrent application

---

[16]Sloth is often subjectively perceptible but less often objectively quantifiable. It may therefore be difficult to establish the benefit or conflict that triggers fiduciary liability.

[17]*See* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 290-91 (1986). See also the transcript of the 1985 Business Roundtable discussion published by Larry E. Ribstein, ed., *Edited Transcript of Proceedings of the Business Roundtable/Emory University Law and Economics Center Conference on Remedies Under the ALI Proposals: Law and Economics*, 71 CORNELL L. REV. 357, 367-71 (1986). It has been supposed that American courts sometimes use the duty of care "as a surrogate for the duty of loyalty." *See* David M. Phillips, *Principals of Corporate Governance*, 52 GEO. WASH. L. REV. 653, 660-61 (1984).

[18]Consider Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 56 FORDHAM L. REV. 375, 382-85 (1988); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 599 (1997); Kenneth E. Scott, *The Role of Preconceptions in Policy Analysis in Law: A Response to Fischel and Bradley*, 71 CORNELL L. REV. 299 (1986). *See also* Stanley A. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. LAW. 883, 888 (1976):

> As to the director, it is questionable whether the duty to use due care or to avoid negligence is a fiduciary duty as distinct from a mere requirement of adequacy of performance or a breach of a contractual or other non-fiduciary duty. It is not, for example, said that the motorist who wrongfully causes a collision with your car is a derelict fiduciary or that the carpenter who constructs a table of the wrong size is a violator of fiduciary obligations.

[19]They treat shirking as a bridging behavior connecting opportunism and negligence. Properly understood, however, shirking is a behavior that in given circumstances can be a breach of loyalty, or a breach of care, or both, or no breach at all.

to distinct mischiefs (opportunism and lack of care).[20] It may be that a particular instance of shirking (e.g., indolence) is concurrently actionable as both a breach of loyalty and a breach of care, but that does not mean there is no substantive distinction between the two duties. It means only that the conduct is such that it can be characterized as either form of mischief. On this point, it is worth noting the position in the British Commonwealth, where, unlike the position in the United States, fiduciary accountability contemplates only the duty of loyalty.[21]

The foregoing distinctions are real ones. Unfortunately, some or all of them are either ignored or passed over in many legal and economic analyses. That leads to confusion over the nature and scope of the different regimes of legal regulation. Fiduciary regulation, in its conventional formulation, controls the mischief of opportunism (which includes unacceptable shirking). It does not purport to control either exchange opportunism or negligence per se, which are regulated in other ways.

A number of other observations are in order. The first relates to the form of opportunism that here may be labeled enforcement opportunism. The concern is that actors with legal rights might have an incentive, said to be perverse, to enforce their rights strategically by instituting litigation to extract concessions. A standard example is a minority shareholder instituting a derivative action to resist the implementation of a given proposal. The example is enriched, so to speak, by the suggestion that the suit is driven by the prospect of legal fees.[22] That is another instance of opportunism that is *not* actionable as a fiduciary breach. The usual control on that opportunistic behavior is an application to dismiss the claim as frivolous or as not disclosing a cause of action. More generally, opportunistic litigation or enforcement of rights is a risk that everyone bears in a society where citizens have private rights. The risk that enforcement might in some cases be opportunistic is hardly a reason to remove the right itself.

A second observation is that opportunism is not actionable as a fiduciary breach where there is consent. In some circumstances, one party will consent to gains realized by another party who has what would otherwise be a conflict of interest. It is not uncommon, for example, for corporate participants in a joint venture to permit each other to compete with the partnership business. In other cases, parties may consent to the *existence*

---

[20]*See* Flannigan, *supra* note 1, at 86; Robert Flannigan, *Fiduciary Regulation of Sexual Exploitation*, 79 CAN. B. REV. 301, 305-06 (2000).

[21]*See* Bristol & W. Bldg. Soc'y v. Mothew, [1998] Ch. 1 (C.A.) (U.K.); Breen v. Williams (1996), 186 C.L.R. 71 (H.C.) (Austl.); K.L.B. v. British Columbia [2003] 2 S.C.R. 403 (Can.).

[22]Fischel & Bradley, *supra* note 17, at 271-73.

of a conflict of interest or conflict of duty, though not to actual self-dealing. That is, parties will be allowed to act despite the existence or presence of a conflict, the expectation being that they will not allow the conflict to affect their judgment.[23] Directors, for example, may be permitted (even invited) to sit on the boards of competing corporations for information collection purposes (perhaps price-fixing purposes). Other examples involve tolerating (consenting to) conflicts on particular matters. Directors are often allowed to set their own pay rates. They are also allowed to decide whether free cash flow should be distributed to investors or retained by the firm for other projects. In the latter instance, the conflict is found in the supposed preference of managers for internal growth that will generally increase their power and influence.[24] Investors consent to these sorts of conflicts because the existence of the conflict is potentially harnessed to the overall welfare of the business (pay incentives ostensibly increase effort, growth may increase net returns) or perhaps because alternative decision processes are even more problematic. While there may be negative consequences from giving such consent, those consequences will not be actionable as fiduciary breaches unless there is proof the party actually succumbed to impermissible self-regard.

A third observation is that opportunism will not be actionable where, as a pragmatic matter, collateral benefits cannot be satisfactorily established by evidence. There are all kinds of non-pecuniary benefits that motivate actors to opportunistically tailor their actions. They may implement transactions in ways that produce useful business or social connections. Or they may direct resources to parties who share their ideological or other allegiances. That opportunism can at times be a significant cost to principals, but the benefits conferred on fiduciaries may not be detectable or measurable.

The last preliminary observation is that conventional fiduciary regulation is not concerned with the merits or propriety of good faith exercises of authority or discretion. That has been one of the more significant confusions in the legal analysis of the fiduciary jurisdiction.[25] Fiduciaries, for example, are sometimes required in the course of their work to choose between conflicting claims. Trustees may have to exercise a

---

[23]Because the existence of the conflict is permitted, the burden on the beneficiary changes from proving the conflict to proving actual self-interested conduct.

[24]*See* Victor Brudney, *Dividends, Discretion, and Disclosure*, 66 VA. L. REV. 85 (1980); Frank H. Easterbrook, *Two Agency-Cost Explanations of Dividends*, 74 AM. ECON. REV. 650 (1984); Daniel R. Fischel, *The Law and Economics of Dividend Policy*, 67 VA. L. REV. 699 (1981); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986). *See also infra* text accompanying notes 85-88.

[25]*See* Flannigan, *supra* note 1.

discretion to make differential distributions to separate beneficiary classes. Directors may have that same discretion. In one sense, these are "conflicts of interest." They are, however, general economic conflicts between the various classes of beneficiaries or shareholders, and not personal conflicts of the trustees or directors. They are merely the competing claims that trustees and directors are required to assess or resolve in the performance of their duties. There is no fiduciary issue in such cases unless the exercise of authority or discretion is calculated to produce an unauthorized benefit (e.g., kickbacks or vote buying).[26]

III. THE ECONOMIC LITERATURE

Neoclassical economic theory (price theory) essentially ignores opportunism. Production and exchange are modeled in conditions of full information, fully contingent contracting (addressing all contingencies) and perfect competition, where opportunism is impossible. Nothing, it will be appreciated, could be more unrealistic. Those conditions are not commonly found in real environments. It is therefore no surprise that opportunism is latent everywhere.[27]

The analysis of opportunism by economists is popularly associated, at least in the legal community, with the "principal/agent" or "agency cost" commentary.[28] For economists, the issue is how to motivate self-interested agents where information is asymmetric, behavioral and cognitive limitations exist, and monitoring is not feasible.[29] Economists concern themselves with

---

[26]A more subtle opportunism may operate in that fiduciaries might choose between formally equivalent claims on the basis of their own preferences for personality, process or other intangibles. To the extent that is not simply an aspect of judgment or perhaps a community of interest or vision in some benign sense, it often cannot be established as a matter of evidence.

[27]Where one has access for an other-regarding purpose, the default principle is that any personal benefit or conflict of interest is proscribed. That would include, for example, the casual taking of coincidental benefits in the course of fully performing nominate tasks. In that respect, opportunism for legal purposes is wider than Williamson's definition of opportunism as "a condition of self-interest seeking with guile." *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 30 (1985). There is no requirement to show "guile" to establish fiduciary liability.

[28]Economists are responsible for the phrase "agency costs," but obviously not for the insight that agents may choose to pursue their own interests. That mischief has been within our conscious contemplation from the beginning of sentient life. Agency costs are simply the tradeoff for the efficiencies that drive the use of agents. For the particular agency cost of opportunism, human nature being what it is, there is no prospect of its complete elimination. It is a matter of management, whether economic or legal.

[29]*See, e.g.*, Kenneth J. Arrow, *The Economics of Agency*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 37-51 (John W. Pratt & Richard J. Zeckhauser eds., 1985); Steven N. S. Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1 (1983); Robert Gibbons, *Incentives in Organizations*, 12 J. ECON. PERSP. 115 (1998); Sanford J. Grossman & Oliver D. Hart,

opportunism in all of its manifestations.[30] For the most part, they do not make substantive distinctions between production opportunism, exchange opportunism and shirking. For them, each behavior presents the same economic problem. How can agents be induced to act in the best interest of their principals? Economists do at times differentiate between low effort and self-dealing, but they rarely focus on the latter (as lawyers do) as a special or unique concern. Their primary interest is in analyzing the nature and limits of contractual and other mechanisms (e.g., reputation, markets, integration) that might ameliorate the agency problem. In that endeavor, they have concentrated on shirking and exchange opportunism. When they do address production opportunism, their analysis does not change. That is to be expected because opportunism in every context will ostensibly be responsive to economic incentives or mechanisms.

The principal/agent discussion has had a particular application in theorizing about the nature of the firm.[31] Much of the discussion is concerned with the difference between firms and markets and how they displace each other. Coase[32] and Williamson[33] concluded that the key

---

An Analysis of the Principal-Agent Problem, 51 ECONOMETRICA 7 (1983); Srabana Gupta & Richard E. Romano, *Monitoring the Principal With Multiple Agents*, 29 RAND J. ECON. 427 (1998); Milton Harris & Artur Raviv, *Some Results on Incentive Contracts With Applications to Education and Employment, Health Insurance, and Law Enforcement*, 68 AM. ECON. REV. 20 (1978); Bengt Holmstrom, *Moral Hazard and Observability*, 10 BELL J. ECON. 74 (1979); Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981); James A. Mirrlees, *The Optimal Structure of Incentives and Authority Within an Organization*, 7 BELL J. ECON. 105 (1976); Ray Rees, *The Theory of Principal and Agent: Part I*, 37 BULL. ECON. RES. 3 (1985); Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973); David E.M. Sappington, *Incentives in Principal-Agent Relationships*, 5 J. ECON. PERSP. 45 (1991); Steven Shavell, *Risk Sharing and Incentives in the Principal and Agent Relationship*, 10 BELL J. ECON. 55 (1979); Jean Tirole, *The Multicontract Organization*, 21 CAN. J. ECON. 459 (1988); Ann van Ackere, *The Principal/Agent Paradigm: Its Relevance to Various Functional Fields*, 70 EUR. J. OPERATIONAL RES. 83 (1993); William D. White, *Information and the Control of Agents*, 18 J. ECON. BEHAV. & ORG. 111 (1992).

[30]They sometimes use "free riding" and "moral hazard" as alternative descriptors for shirking or opportunism.

[31]Harold Demsetz, *The Firm in Economic Theory: A Quiet Revolution*, 87 AM. ECON. REV. 426 (1997); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Flannigan, *supra* note 6, at 111-12.

[32]R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA (n.s.) 386 (1937). *See also* R.H. Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713 (1992); Ronald H. Coase, *The Relevance of Transaction Costs in the Economic Analysis of Law*, *in* THE ORIGINS OF LAW AND ECONOMICS 199-221 (Francesco Parisi & Charles K. Rowley eds., 2005).

[33]*See* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975). Williamson couples opportunism with bounded rationality. *See also* Matthew Klaes, *The Birth of the Concept of Transaction Costs: Issues and Controversies*, 9 INDUS. & CORP. CHANGE 567 (2000); Claude Ménard, *Transaction Cost Economics: From the Coase Theorem to Empirical Studies*, *in* THE INSTITUTIONAL ECONOMICS OF RUSSIA'S TRANSFORMATION 45, 45-64 (Anton N. Oleinik ed., 2005). Transaction cost methodology requires the evaluation of

determinants in the "make or buy" decision were the relative transaction costs (including opportunism costs) of the two forms of coordinating production.[34] One of the main costs favoring the vertical integration of a process into a firm is the cost of high asset specificity. As mentioned earlier, where an asset is highly specialized to a process, the prospect of opportunistic holdup can be significant, and one solution is to remove the exchange interface by integrating the process.[35] The mischief here, it will be recognized, is exchange opportunism, which is not legally actionable as a fiduciary breach. Accordingly, the whole discussion of asset specificity, as it has developed to date, does not raise any issue of conventional fiduciary obligation. That does not mean, however, that the relevant opportunism is not addressed in economic theorizing about the firm. The establishment of a firm (or its expansion by vertical or horizontal integration) installs production and thereby gives rise to the prospect of production opportunism.[36] The economic literature on the firm traverses the problem and investigates the mechanisms that might control it.[37]

---

relative costs. Economists have yet to operationalize that methodology for the law of fiduciary duty. Consider Oliver E. Williamson, *The Economics of Governance*, 95 AM. ECON. REV. 1 (2005).

[34]Transaction costs are not consistently defined in the literature. *See* Douglas W. Allen, *Transaction Costs*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 893 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000). Where limited to the costs of *exchange*, they are distinguished from production and other costs (e.g., political costs). *See also* Richard N. Langlois, *The Secret Life of Mundane Transaction Costs* (Univ. Conn. Econ. Working Paper No. 2005-49, 2006), *available at* http://ssrn.com/abstract_id=893197.

[35]*See supra* note 8; Trond E. Olsen, *Agency Costs and the Limits of Integration*, 27 RAND J. ECON. 479 (1996); Michael D. Whinston, *On the Transaction Cost Determinants of Vertical Integration*, 19 J.L. ECON. & ORG. 1 (2003).

[36]Observe that vertical integration prompted by asset specificity essentially involves trading exchange opportunism for production opportunism. Note that the overall potential for production opportunism does not change fundamentally. There has simply been a transfer of production, with its associated opportunism, from one firm to another.

[37]*See, e.g.*, George Baker et al., *Bringing the Market Inside the Firm?*, 91 AM. ECON. REV. 212 (2001); George Baker et al., *Relational Contracts and the Theory of the Firm*, 117 Q. J. ECON. 39 (2002); Graham Brownlow & Frank Geary, *Puzzles in the Economic Institutions of Capitalism: Production Coordination, Contracting and Work Organization in the Irish Linen Trade, 1750-1850*, 29 CAMBRIDGE J. ECON. 559 (2005); Mathias Dewatripont & Jean Tirole, *A Theory of Debt and Equity: Diversity of Securities and Manager-Shareholder Conflicts*, 109 Q. J. ECON. 1027 (1994); Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327 (1983); Pierre Garrouste & Stéphane Saussier, *Looking For a Theory of the Firm: Future Challenges*, 58 J. ECON. BEHAV. & ORG. 178 (2005); Robert Gibbons, *Four Formal(izable) Theories of the Firm?*, 58 J. ECON. BEHAV. & ORG. 200 (2005); Oliver D. Hart, *The Market Mechanism as an Incentive Scheme*, 14 BELL J. ECON. 366 (1983); Bengt Holmstrom & Paul Milgrom, *The Firm as an Incentive System*, 84 AM. ECON. REV. 972 (1994); Anke S. Kessler, *The Value of Ignorance*, 29 RAND J. ECON. 339 (1998); Jean-Jacques Laffont & David Martimort, *Collusion and Delegation*, 29 RAND J. ECON. 280 (1998); Claude Menard, *The Economics of Hybrid Organizations*, 160 J. INST'L & THEORETICAL ECON. 345 (2004); Candice Prendergast, *A Theory of "Yes Men,"* 83 AM. ECON. REV. 757 (1993); Roy Radner, *Hierarchy: The Economics of Managing*, 30 J. ECON. LIT. 1382 (1992); Raghuram G. Rajan & Luigi Zingales, *The Firm as a Dedicated Hierarchy: A Theory of the Origins and Growth of Firms*, 116 Q. J. ECON. 805 (2001);

A companion development in the literature was the formulation of the team production model of the firm.[38] Alchian and Demsetz believed it was a delusion to "see the firm characterized by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in the conventional market."[39] Their view was that the contracts that comprised the firm were no different than other contracts. They argued that firms arose in response to difficulties in metering productivity in teams where individual team members might choose to shirk. As they saw it, "since costs must be incurred to monitor each other, each input owner will have more incentive to shirk when he works as part of a team, than if his performance could be monitored easily or if he did not work as a team."[40] The solution to the shirking concern was for the team members to appoint a central agent who would "specialize as a monitor to check the input performance of team members."[41] To encourage central agents themselves to not shirk, they would be assigned the residual gain from production.

It should be apparent that there are a number of weaknesses with the team production model.[42] It does not give due recognition to the reality of "fiat," or to the fact that central agents (rather than team members) typically initiate investments and finance those investments by drilling through investor pools. There is also a failure to recognize the durability of the contracts that comprise a firm.[43] Moreover, as Alchian and Demsetz framed

---

Rafael Rob & Peter Zemsky, *Social Capital, Corporate Culture, and Incentive Intensity*, 33 RAND J. ECON. 243 (2002); Andrei Shleifer & Robert W. Vishnay, *Politicians and Firms*, 109 Q. J. ECON. 995 (1994).

[38]Flannigan, *supra* note 6, at 118-20.

[39]Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972). *See also* JACOB MARSCHAK & ROY RADNER, ECONOMIC THEORY OF TEAMS (1972); J. Marschak, *Elements For a Theory of Teams*, 1 MGMT. SCI. 127 (1955). Consider Herbert A. Simon, *A Formal Theory of the Employment Relationship*, 19 ECONOMETRICA 293 (1951).

[40]Alchian & Demsetz, *supra* note 39, at 780.

[41]*Id.* at 781.

[42]Fama concluded that the Alchian and Demsetz insight was "not carried far enough." Fama, *supra* note 31, at 289. *See also* Jensen & Meckling, *supra* note 12, at 310 ("We sympathize with the importance they attach to monitoring, but we believe the emphasis which Alchian-Demsetz place on joint input production is too narrow and therefore misleading."); Mukesh Eswaran & Ashok Kotwal, *The Moral Hazard of Budget-Breaking*, 15 RAND J. ECON. 578 (1984); Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. 324 (1982); Bengt Holmstrom & Jean Tirole, *The Theory of the Firm*, *in* 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 66, 66-68 (Richard Schmalensee & Robert D. Willig eds., 1989).

[43]As to why agents ordinarily do take instruction from their principals, rather than treating each encounter as a renegotiation opportunity, see Philippe Aghion & Jean Tirole, *Formal and Real Authority in Organizations*, 105 J. POL. ECON. 1 (1997); Flannigan, *supra* note 6, at 119; Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990); James A. Miralees, *The Optimal Structure of Incentives and Authority Within an Organization*, 7 BELL J. ECON. 105 (1976); John Moore, *The Firm as a Collection of Assets*, 36 EUR. ECON. REV. 493 (1992). According to Hart, workers comply because their employers have property rights to

it, the model addresses undifferentiated shirking. Accordingly, because it applies beyond production opportunism, it cannot usefully inform our understanding of conventional fiduciary accountability. The model is only another conceptual formulation (a strained one) of how the firm could be perceived as a response to the principal/agent problem.

Another development in the economic literature that has had an impact on legal scholarship is the idea that the firm is a "nexus of contracts."[44] Although the team production model is a nexus concept (as are all multiparty models), the nexus of contracts phrase is popularly associated with the subsequent work of Jensen and Meckling, who, it should be noted, failed to develop the notion beyond its mere assertion.[45] The idea is that:

> [I]t makes little or no sense to try to distinguish those things which are "inside" the firm (or any other organization) from those things that are "outside" of it. There is in a very real sense only a multitude of complex relationships (i.e., contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output.[46]

This view of the firm has little substantive content.[47] At its level of generality, it cannot be challenged. That is because it is true in a trite sense. It must be obvious that the input and output contracts constituting and bridging firms have connection points. That tells us nothing about the nexus point itself—the point of conscious coordination of control rights (as opposed to their mere acquisition) into actual production.[48] It amounts to a reassertion of the neoclassical black-box view of the firm, where nothing inside the firm is important.[49] What the nexus idea does appear to offer, at

---

withdraw the assets that workers use to perform their tasks. *See* Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1770-71 (1989). Essentially, though he might disagree, Hart is saying that workers comply because they can be fired. There is less of a durability concern where the requisite physical and human capital is generally fungible.

[44]Flannigan, *supra* note 6, at 120-21.

[45]*See* Jensen & Meckling, *supra* note 12.

[46]*Id.* at 311.

[47]A point conceded by Jensen and Meckling. *Id.* It is of some significance that the nexus of contracts notion has had no fundamental impact in the economic literature.

[48]To accommodate the reality of production, each node of the nexus must represent an array of specific control rights (acquired through control contracts) that a particular controller or control group coordinates at any given time. The nodes of conscious coordination are distinguishable from each other by control boundaries. The arrays of control rights and the composition of control groups are in constant flux. *See* Flannigan, *supra* note 6.

[49]Some economists explicitly take that view. *See* Benjamin Klein, *Contracting Costs and Residual Claims: The Separation of Ownership and Control*, 26 J.L. & ECON. 367, 373 (1983):

> Coase mistakenly made a sharp distinction between intrafirm and interfirm transactions, claiming that while the latter represented market contracts the former

least for some, is ideology.[50] If it is conceded that the firm is only contract (so the argument goes), there is little room for social regulation premised on state concession or any other formal social responsibility. That argument, however, does not survive the observation that contract itself is a state construction.[51] It thus appears that the nexus idea does not usefully explain conventional fiduciary obligation. As it is, although the nexus of contracts assertion frequently appears as an unqualified and undeveloped starting premise in legal commentaries, the idea has never demonstrated any independent analytical cut on fiduciary issues.[52] It appears to amount to little more than a label for the banality that coordination involves connection.

It is convenient at this point to address another proposition found in the Jensen and Meckling analysis. They argue that buyers of securities will anticipate opportunism by managers and factor it into the price they pay.[53] That might suggest that managers could credibly argue that opportunistic benefits are unobjectionable because their firms have implicitly consented to those benefits by accepting the opportunism discount. Obviously, however, the discount is not a recognition of future *actual* opportunism. Rather, it is a discount reflecting only the *risk* of opportunism. Jensen and Meckling include in the discount the expected monitoring costs for opportunism, and therefore do not imply that the discount justifies actual opportunism. It may be added that the law can hardly accept the argument that liability is attenuated or eliminated because the misbehavior can be *foreseen*.

The concerns described above (production opportunism, exchange opportunism, shirking) are viewed by economists as consequences of incomplete contracting, and there is now a growing capacious (inchoate) literature identified by that label.[54] It appears, however, that little new

---

represented planned direction. Economists now recognize that such a sharp distinction does not exist and that it is useful to consider also transactions occurring within the firm as representing market (contractual) relationships. The question what is the essential characteristic of a firm now appears to be unimportant.

[50]*See* Brudney, *supra* note 11, at 1409.

[51]Bargains are both facilitated and constrained by state (legislative and judicial) regulation. There is no significant difference between corporate and contract regulation in terms of either quality or quantity. We *need* regulation. The only contest is over its *shape*. Recognizing that, the contract argument then becomes that contracts in the nexus should be regulated by the state in the same way as other contracts. The trouble with that argument is that states regulate different contracts in different ways to address different or variable social impacts. Employment contracts, for example, are explicitly regulated very differently than simple purchases of goods. Further, the corporate nexus of contracts has the feature of limited liability, which has obvious third-party social effects requiring the attention of the community (the state).

[52]*See also* Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002); Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999).

[53]Jensen & Meckling, *supra* note 12, at 317-26.

[54]*See* Daniel W. Elfenbein & Josh Lerner, *Ownership and Control Rights in Internet Portal Alliances, 1995-1999*, 34 RAND J. ECON. 356 (2003); Oliver Hart & John Moore, *Foundations of*

insight into conventional fiduciary regulation flows from focusing on the causes or consequences of incomplete contracts. The first difficulty is that fiduciary accountability is not limited to arrangements created by negotiated contracts. A second difficulty is that, contrary to the assumption in some commentaries, incomplete contracts are not necessarily deficient contracts. For many limited access arrangements, the understood function of the contract is to *be incomplete*, in the sense that it confers discretion on either the principal or the agent in order to allow creative adaptation and innovation (as opposed to merely defensively reacting to information asymmetry), whether or not environments change. It is a *positive choice* of contingency—the contract is *efficiently incomplete*—or *complete by discretion*. An expected consequence or cost of that choice, however, is to create exposure to the risk of opportunism. At that point, it is again only the standard principal/agent problem. A third difficulty is that incomplete contracting per se has no necessary linear connection with opportunism in any context. Opportunism typically occurs *despite* the terms of a contract, including terms addressing opportunism. It is a behavior that simply cannot be eradicated by complete contracting with full information. Even where principals specify consequences for opportunism and have full knowledge when it occurs, agents will still pursue their own self-interest where, for example, they spontaneously choose to regard the relation as an end game.[55] Most principals and agents, of course, have nothing like full information about the actions or knowledge of each other, and the potential for opportunism will be pervasive in real relations. The solution for principals, as before, is to attempt to better align their interests with those of their agents, whether by formal or informal incentives. Finally, the incomplete contract model invariably adopts the standard economic assumption of rational self-interest and seeks to find ways to channel or harness that self-interest for the benefit of the principal. That ethic is superficially different from the legal approach of mandating selfless regard for others in limited access arrangements, and it may be a source of confusion for some. The reality, it will be appreciated, is that fiduciary relations do involve self-

---

Incomplete Contracts, 66 REV. ECON. STUD. 115 (1999); Eric Maskin & Jean Tirole, *Unforeseen Contingencies and Incomplete Contracts*, 66 REV. ECON. STUD. 83 (1999); Patrick W. Schmitz, *The Hold-Up Problem and Incomplete Contracts: A Survey of Recent Topics in Contract Theory*, 53 BULL. ECON. RES. 1 (2001); Ilya Segal, *Complexity and Renegotiation: A Foundation For Incomplete Contracts*, 66 REV. ECON. STUD. 57 (1999); Jean Tirole, *Incomplete Contracts: Where Do We Stand?*, 67 ECONOMETRICA 741, 743 (1999) ("For all its importance, there is unfortunately no clear definition of 'incomplete contracting' in the literature.").

[55]Expected repeat interaction (an expectation of fuller information or monitoring) dampens the probability of opportunism. Consider Robert Gibbons, *Firms (and Other Relationships)*, *in* THE TWENTY-FIRST-CENTURY FIRM 186, 186-99 (Paul Dimaggio ed., 2001); Robert Gibbons, *Trust in Social Structures: Hobbes and Coase Meet Repeated Games*, *in* TRUST IN SOCIETY 332, 332-53 (Karen S. Cook ed., 2001).

interest on both sides. The difference is that fiduciaries agree, in an expression of self-interest, to accept limits on their self-interest.

It should be noted that the incomplete contracting literature developed as a generalization of initial work that is now referred to as the "property rights" approach.[56] Grossman, Hart and Moore have argued that asset ownership is a significant factor in reducing the risk of opportunism associated with incomplete contracting.[57] Ownership is important, according to them, because it represents the residual right to control an asset where a contract involving that asset is incomplete.[58] Possession of the right to control will, for example, counter exploitation of asset specificity. There are, however, conceptual weaknesses with such an approach.[59] One is that it unrealistically locates human capital outside the firm. Another is that specific control rights, rather than residual control rights, are far more important to actual production processes.[60] More generally, it must be evident that the property rights approach does not explain the efficiency of conventional fiduciary regulation. It merely identifies another mechanism (residual control) that potentially broadly regulates opportunism, primarily

---

[56]In turn, the property rights literature ostensibly "builds on the earlier transaction cost literature." *See* Oliver Hart & Bengt Holmstrom, *A Theory of Firm Scope*, 1 n.1 (MIT Dept. of Econ. Working Paper No. 02-42, 2002), *available at* http://ssrn.com/abstract_id=355860. Consider Michael D. Whinston, *Assessing the Property Rights and Transaction Cost Theories of Firm Scope*, 91 AM. ECON. REV. 184 (2001).

[57]*See* OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 24-27 (1995); Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Lateral and Vertical Integration*, 94 J. POL. ECON. 691 (1986); Hart, *supra* note 43, at 1763; Hart & Moore, *supra* note 43; Moore, *supra* note 43.

[58]Holmstrom and Tirole summarize the property rights position as follows:

> Residual decision rights are those rights to control that have not been explicitly contracted for beforehand. In Grossman and Hart's framework, the allocation of residual decision rights is identified with the ownership of assets. Thus, ownership defines the default options in an incomplete contract. A transaction within the firm (concerning the firm's assets) is controlled by the owner of the firm (or the manager, if he has been delegated the authority) in those situations where the contract does not specify a unique course of action. In contrast, a market transaction must be resolved through negotiation between relevant asset owners if the contract is incomplete. These two modes of transaction will imply a different division of the surplus from the relationship ex post and therefore lead to different levels of investment in relationship specific capital ex ante.

Holmstrom & Tirole, *supra* note 42, at 69 (citation omitted).

[59]*See, e.g.*, Hart & Holmstrom, *supra* note 56; Bengt Holmstrom, *The Firm as a Subeconomy*, 15 J.L. ECON. & ORG. 74 (1999); Eric Maskin & Jean Tirole, *Two Remarks on the Property-Rights Literature*, 66 REV. ECON. STUD. 139 (1999). Consider Moore, who insisted that the property rights approach did not suffer from the various deficiencies he associated with transaction cost analysis. Moore, *supra* note 43, at 495.

[60]*See* Flannigan, *supra* note 6, at 128-30. *See also* Raghuram Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q. J. ECON. 387 (1998). Rajan and Zingales recognize the importance of specific control, which they frame as *access* to physical and human capital.

exchange opportunism. Fiduciary accountability is a separate regulating mechanism and, importantly, one that is narrower in terms of the opportunism it targets.

To this point, we have examined what economics tells us about opportunism. We now turn to consider what it has to say about fiduciary accountability as a mechanism to discipline opportunism. Unfortunately there is little at hand. Hart is one of very few economists who have attempted an economic analysis of fiduciary obligation.[61] His essay addressed the stakeholder debate. The difficulty with his analysis is that, in assessing which stakeholders should be owed a fiduciary duty, he *assumes* an overly broad function for fiduciary regulation. That is a general concern with fiduciary analysis in the legal community, and Hart acknowledges that his analysis is largely a gloss on the work of several legal scholars.[62] He appears to believe, for example, that fiduciary obligation has application to how directors mediate or resolve conflicts between classes of beneficiaries (e.g., shareholder, creditor and shareholder/creditor conflicts).[63] He also seems to hold the curious view that fiduciary regulation should vary according to the contractual protection (self-help) available to different classes of beneficiaries.[64] None of that corresponds with the conventional obligation, which is directed to controlling opportunism in limited access arrangements and does not depend on estimations of contractual self-help. Consequently, Hart's analysis is not helpful in clarifying or contesting the conventional position.[65]

It appears that the work of economists has yet to add fresh insight to our comprehension of fiduciary accountability. Economists have prodigiously assessed economic mechanisms that purport to control opportunism (contractual incentives, markets, etc.) in all contexts, but have shied away from evaluating the primary legal mechanism. They are

---

[61]Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299 (1993). Economists have specifically addressed the efficiency of statutory insider trading laws (the literature is thought to be inconclusive), but not conventional fiduciary regulation, which differs from the typical statutory provisions. *See* Laura Nyantung Beny, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, 32 J. CORP. L. 237 (2007).

[62]Hart, *supra* note 61, at 302.

[63]On a proper conventional analysis, neither of these classes would be owed a fiduciary duty. *See* Flannigan, *supra* note 3.

[64]The conventional position is that fiduciary accountability has a constant generic application that does not vary with the relative economic resources or bargaining power of the parties. *See* Flannigan, *supra* note 1, at 42.

[65]Hart states that "fiduciary duty is an interesting concept only in a world where comprehensive contracts are impossible." Hart, *supra* note 61, at 306. Hart's comment illustrates how economists frame the root problem as incomplete contracting rather than opportunism per se.

obviously capable of making a contribution. They could investigate whether conventional fiduciary accountability is efficient. Their analysis could include evaluations of the various alternative conceptions of fiduciary responsibility that have recently confused the jurisprudence. That would require a clear understanding on their part of the differences between the conventional position and the alternative legal conceptions. To date, however, economists themselves concede that their contribution to the analysis of fiduciary accountability has been limited.[66] We now proceed to consider whether legal commentators have been any more successful than economists in utilizing economic concepts to advance our understanding of fiduciary responsibility.

IV. LAW AND ECONOMICS

It is initially prudent to reiterate the observation made earlier about the confusion over the perceived scope of fiduciary accountability. Many judges and commentators today harbor the view that the fiduciary jurisdiction extends beyond the conventional function of controlling opportunism in limited access arrangements. Typically, the assumption is that fiduciary regulation extends to assessing the substantive merits or "fairness" of an exercise of judgment or authority, notwithstanding the absence of any issue of self-dealing. As I have explained elsewhere, those extensions past the conventional boundaries are entirely the result of the conceptual and linguistic imprecision that has plagued this area of the law.[67] It was also observed earlier that, although the substantive difference is usually recognized, the American jurisprudence includes both a duty of care and a duty of loyalty under the "fiduciary" umbrella.[68] That, too, may skew the comprehension of those assuming the conventional position, particularly where a supposed "fiduciary" commentary is concerned largely or exclusively with duty of care matters. With that additional understanding of the variation in the conceptual topography, the following analysis should be more accessible.

Posner, it may first be observed, only briefly mentions fiduciary obligation.[69] In the agency context, he sees it as the legal response to the problem of unequal costs of information: "It allows you to hire someone with superior information to deal on your behalf with others having superior

---

[66] *Id.* at 299, 313.

[67] *See* Flannigan, *supra* note 1; Flannigan, *supra* note 2; Flannigan, *supra* note 3.

[68] *See supra* text accompanying notes 17-21.

[69] RICHARD A. POSNER, THE ECONOMIC ANALYSIS OF LAW 114-15 (6th ed., 2003).

information."[70] Imposing the duty "minimizes the costs of self-protection to the fiduciary's principal."[71] These remarks are unclear. Posner initially seems to be saying that the purpose of default fiduciary accountability is to economize on the transaction costs (e.g., learning costs, value forgone) that would otherwise be incurred in personally dealing with another person who has superior information. His second comment, however, suggests that the purpose is to provide protection against the opportunism of agents. Presumably both purposes are served because attenuating opportunism facilitates or fosters the associated nominate function. But what is the fiduciary purpose? The answer matters because clarity of purpose is of particular importance given the current state of confusion in the fiduciary jurisprudence.[72]

Fiduciary accountability has received the most attention in the literature dealing with the economic analysis of corporate law.[73] Beginning with Manne in the 1960s, corporate scholarship increasingly has turned to economic arguments.[74] Manne engaged the economic analysis of fiduciary accountability with two propositions. His more general observation was that managerial behavior was constrained by markets, particularly the market for control.[75] He believed that markets were especially effective at policing "mere inefficiency," which was managerial weakness in the sense of poor judgment or decisionmaking.[76] He also believed, however, that market forces "constrain managers in a far more significant fashion than does the derivative suit, though the latter definitely answers a special need."[77] Although that special need was not further clarified, it appears that Manne recognized the utility of the duty of loyalty.

The narrower and more provocative proposition advanced by Manne was that insider trading was not objectionable and instead usefully served to compensate insiders for their services.[78] That raised a debate that continues

---

[70] *Id.* at 114.

[71] *Id.*

[72] Posner's later laconic comments on the transfer of corporate control do not offer any additional clarity. *See id.* at 428-32.

[73] The literature on the economic analysis of other areas of the law is referenced at *infra* note 150.

[74] *See* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259 (1967).

[75] *See also* Henry G. Manne, *Mergers and the Market For Corporate Control*, 73 J. POL. ECON. 110 (1965); Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427 (1964).

[76] Manne, *supra* note 74, at 273.

[77] *Id.*

[78] HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 138-41 (1966).

today.[79] From a conventional perspective, the issue is a fiduciary one only in part. Insider trading is said to affect both the firm that employs the insider and third parties who trade with or at the same time as the insider. With respect to the firm, insiders who have authority to make significant (market-moving) decisions are in a conflict of interest position. They have an incentive to make operational decisions that will cause the prices of securities of their firms (or other firms) to move in directions that will produce a personal benefit for them. That is a classic conflict of interest, with the conflicted decisions obviously having potentially serious consequences for the firm. The conventional analysis of the situation is that the firm consents to the *existence* of the conflict when it permits or invites managers to hold firm shares. That consent is normally given because holding firm shares will ostensibly align the interests of the managers with the firm. The accompanying expectation is that the managers will not allow themselves to be influenced by the conflict. If managers do actually allow their judgment to be compromised by self-interest, they will be liable. The firm only consented to the existence of the conflict, not the manager actually yielding to it. Insiders who do not have market-moving authority, as well as those who do, will also commit a fiduciary breach where they simply trade on confidential information acquired in the course of a limited access relationship with the firm. On the other hand, there usually is no fiduciary issue at all between insiders and third-party traders because there is no limited access relationship between them. Subject to a fact-based obligation arising, there is no undertaking by one to act in the interest of the other. It is at that point that the debate over insider liability should properly begin. The question is then what sort of liability (other than fiduciary liability), if any, insiders should have to third-party traders.

Following Manne, a decade passed before economic analysis (and critical reaction to it) started to become broadly significant in corporate law. Winter's 1977 assessment of the desirability of federal corporate legislation marks the beginning of a generalized resort to economic arguments.[80] Winter

---

[79]Ian Ayres & Joe Bankman, *Substitutes For Insider Trading*, 54 STAN. L. REV. 235 (2001); Laura Nyantung Beny, *Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence*, 7 AM. L. & ECON. REV. 144 (2005); Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455 (2003); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

[80]Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEG. STUD. 251 (1977), *reprinted with additional material in* RALPH K. WINTER, GOVERNMENT AND THE CORPORATION (1978). *See also* Alison Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. REV. 738 (1978). Anderson is unclear on the precise basis for fiduciary responsibility. Cheating is the mischief, but only some cheating is actionable as a fiduciary breach. In that respect, she apparently sees fiduciary accountability as addressing a difference of degree, rather than one of kind.

employed economic reasoning to challenge the idea that managers preferred jurisdictions that offered slack managerial regulation (the race to the bottom).[81] He believed that state intervention in private matters was only justified if it reduced costs for the parties. The function of corporation codes, on that view, was "to supply standard terms which reduce the transaction costs, and thereby increase the benefits, of investing by eliminating costly bargaining which might otherwise accompany many routine corporate dealings."[82] As for his specific topic, he observed that "interventionist legal rules may reduce the yield to shareholders generally and this cost must be weighed against the benefits to be gained by the reduction of self-dealing or mismanagement."[83] His subsequent analysis involved demonstrating the sensibility of separating ownership and control, and the market discipline (though imperfect) that regulated the potential for opportunism associated with that separation. Much of that discussion compared legal and market controls on managerial discretion. He stated that "establishing a fiduciary duty in the corporate context is exceedingly difficult once one moves beyond blatant self-dealing."[84] Accordingly, although he found fiduciary accountability unsatisfactory for broader functions, he did concede its utility for controlling self-dealing. That conclusion corresponds with the conventional view of fiduciary accountability.

Another contest of economic and legal analysis erupted over the issue of the propriety of dividend payments. Brudney concluded that, although shareholders preferred dividends, managers would indulge a personal bias

---

[81]Winter was primarily responding to the analysis of William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). The debate on the topic continues. *See* Barry D. Baysinger & Henry N. Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179 (1985); Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003); Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775 (2002); Robert Drury, *The "Delaware Syndrome": European Fears and Reactions*, 2005 J. BUS. L. 709; Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982); Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Bottom/Top*, 23 YALE L. & POL'Y REV. 381 (2005); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002); Ehud Kamar, *Beyond Competition For Incorporations*, 94 GEO. L.J. 1725 (2006); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004). The discussion is also relevant to the proliferation of other organization forms. *See* Robert Flannigan, *The Political Path to Limited Liability in Business Trusts*, 31 ADVOC. Q. 257 (2006), *available at* http://ssrn.com/abstract_id=895600.

[82]Winter, *supra* note 80, at 259. It may be observed that "routine" dealings should not involve "costly" bargaining. Further, the range of default terms in typical corporate codes extends well beyond routine matters.

[83]*Id.* at 261.

[84]*Id.* at 282.

for the retention of earnings.[85] Their choice of firm growth enabled them to maximize their power, prestige and perquisites. Fischel questioned that analysis.[86] He believed Brudney had failed to appreciate the market constraints on managerial discretion.[87] He concluded that "managers have no significant incentive to act contrary to the best interests of shareholders in setting dividend policy. Any systematic suboptimal dividend policy will have negative consequences in the managerial services market, the capital market, the product market, and, if prolonged, may trigger a proxy fight or a takeover."[88] The conventional fiduciary analysis of this issue partially accommodates each position. A good faith "inefficient" dividend decision is not a fiduciary matter. Absent negligence, such decisions are exercises of business judgment and are left to the discipline of markets, or possibly oppression actions. If, however, the dividend decision is or is part of a self-dealing arrangement, it will constitute a fiduciary breach, though only to the corporation. The receipt by directors of dividends they declare, it may be added, is not by itself actionable as a fiduciary conflict because the directors have the consent of the corporation to the existence of the conflict.

At about the same time, Easterbrook and Fischel applied an economic analysis to oppose the prevailing assumption that directors were entitled to resist hostile takeover bids they concluded were not in the best interest of the corporation.[89] Their argument was that directors should remain passive because defensive tactics reduced shareholder welfare. The conventional fiduciary analysis here is straightforward. Regulating managerial responses to takeovers is substantively a matter of corporate law. At the same time, however, fiduciary accountability has an independent parallel application (as it does for the exercise of all powers) to control a *self-interested* response to a takeover. The obvious concern for managers is that a successful takeover may result in their dismissal, and they therefore often have an incentive to defeat the offer. Accordingly, if their resistance is grounded in personal self-interest, they are properly charged with a fiduciary breach. There is a difficulty, however, in proving that self-interest, and that has produced

---

[85]Brudney, *supra* note 24.

[86]Fischel, *supra* note 24.

[87]*Id.* at 712-13.

[88]*Id.* at 715.

[89]Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). Consider the earlier analysis of Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978). *See also* Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981). *Cf.* Martin Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231 (1980).

conceptual confusion for the fiduciary jurisprudence.[90] There is also confusion in the jurisprudence over the supposed fiduciary character of the duties potentially owed to various classes of stakeholders. Those duties are relevant in the takeover context because directors might appeal to them to justify their defensive measures. Again, however, unless it involves self-interest, there is no conventional fiduciary regulation of the merits of decisions managers make about the respective claims of competing classes of stakeholders. There may be corporate law or other breaches (e.g., tort breaches, competition breaches) in the above instances, but without an issue of opportunism, there is no fiduciary liability. As for the Easterbrook and Fischel analysis, while the debate over the takeover role of directors continued,[91] no plausible argument has been advanced that the conventional fiduciary responsibility of directors should be abridged.

These early contributions to the literature, and others, generally demonstrated the potential value of economic analysis in the corporate context for both public and private corporations. From that point on, the economic analysis of the legal regulation of opportunism (or reference to that analysis) became commonplace. Possibly the most well-known subsequent work is that of Easterbrook and Fischel, published in two papers a decade apart. While not original to them,[92] their descriptions of the function of fiduciary accountability are often cited.

In their 1982 essay on corporate control transactions, Easterbrook and Fischel observed that the benefits of delegation (agency) were reduced by the mischief of opportunism.[93] Though there are market controls, those controls do not fully eliminate the possibility of opportunism. Markets have costs and are also inadequate to deal with end game interactions.[94] To substitute for costly direct monitoring by principals, the law provides a measure of deterrence in the form of an "elastic" fiduciary principle, which Easterbrook and Fischel described as a "standard-form penalty clause."[95] Fiduciary rules

---

[90]Judges have substituted motive for benefit. *See* Flannigan, *supra* note 3, at 290-91.

[91]*See, e.g.*, William T. Carney, *Controlling Management Opportunism in the Market For Corporate Control: An Agency Cost Model*, 1988 WIS. L. REV. 385; David D. Haddock et al., *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701 (1987); Larry E. Ribstein, *Takeover Defenses and the Corporate Contract Law*, 78 GEO. L.J. 71 (1989); Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621 (2003).

[92]It will be recognized, for example, that providing a template of standard terms (usually a template of experience) to reduce costs is an ancient idea.

[93]Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982) [hereinafter Easterbrook & Fishel, *Corporate Control*]. Consider also Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982).

[94]Easterbrook & Fischel, *Corporate Control*, *supra* note 93, at 701.

[95]*Id.* at 702.

were socially optimal, according to them, if they "approximate the bargain that investors and agents would strike if they were able to dicker at no cost."[96] Such off-the-rack rules reduce "the costs of transacting and of enforcing restrictions on the agent's powers."[97] Easterbrook and Fischel then concluded, in a logic that is opaque, that the function of the fiduciary principle is to maximize the welfare of investors.[98]

All of this would be acceptable if construed narrowly. That is, the hypothetical bargain would have to be a bargain *about* opportunism and would have to represent the *social consensus* about the standard (default) terms of the agreement. Additionally, the duty would have to be to maximize the welfare of the investors only in the specific sense of controlling opportunism and only in limited access arrangements. Obviously, however, the Easterbrook and Fischel description can be construed more broadly than that. They do not themselves adopt a narrow construction. The particular examples they discuss indicate that their conception extends to regulating director decisions about the relative merits of different investments.[99] They generally appear to include within the ambit of their concept the mischiefs of low effort, the consumption of perquisites and the selection of inferior projects.[100] Although they do rightly reject the view that fiduciary regulation is concerned with the unequal treatment of investors, they ultimately conclude that investor welfare "is maximized by a legal rule that permits unequal division of gains from corporate control changes, subject to the constraint that no investor be made worse off by the transaction."[101] That is plainly a rule that purports to guide the ordinary course exercise of director discretion. It would therefore extend "fiduciary" regulation beyond its conventional function of controlling opportunism or, in this particular instance, the opportunistic exercise of discretion.

Observe that Easterbrook and Fischel have actually identified two functions for fiduciary responsibility. The welfare-maximizing function is apparently their primary argument, even though their version constitutes an unjustified extension of conventional accountability. The second function they identify is the provision of a standard form set of terms, the purpose of which is to produce information economies and reduce transaction costs. That, it turns out, has been the function more frequently referenced in the

---

[96] *Id.*

[97] *Id.*

[98] The unqualified content of their conclusion does not appear to follow from the standard form argument or any other proposition in this part of their discussion. Further, in the corporate context, the corporation is the formal principal. On this latter point, see Flannigan, *supra* note 3.

[99] Easterbrook & Fischel, *Corporate Control*, *supra* note 93, at 703-04.

[100] *Id.* at 705.

[101] *Id.* at 715.

subsequent literature. Yet it is no more correct, relative to the conventional conception, than the supposed welfare-maximizing argument. There are a number of observations to make about this function. The essential idea (which is not an "economic" one) is that default legal rules are public goods accessible to the population to reduce transaction costs generally. It will be appreciated, however, that every default rule has this public good character. The standard form function, therefore, is a generic one associated with default status per se and not with the specific content of any particular form of legal regulation. It is, at best, an incidental function, as it would be in any other area of the law. Consequently, it cannot be the unique substantive rationale for fiduciary accountability.

That conclusion does not change because Easterbrook and Fischel assert that the content of the rule represents the bargain the parties would have made. Default content actually represents the *social consensus* on the terms or conditions on which given activities or relations may proceed.[102] Default rules constitute affirmative statements by judges and legislators of rights and duties designed to guide behavior (norm signaling). Those default terms can be altered by an actual bargain, subject to varying degrees of economic friction, but otherwise the parties are governed by the communal view of what is appropriate conduct in the circumstances.[103] It may be that the two bargains (specific and social) will often coincide, but that is because the social consensus invariably reflects the choices of reasonable citizens. It is clear, however, that the two bargains may not coincide, since the social consensus incorporates considerations beyond the peculiar interests of the hypothetical bargainers, for example, externalities that might be produced.[104] Accordingly, once the default position is recognized as an instrumental social construction, the hypothetical private bargain rationale evaporates.

---

[102]*See* Flannigan, *supra* note 10, at 209-12. *See also* Robert Flannigan, *Commercial Fiduciary Obligation*, 36 ALBERTA L. REV. 905 (1998). Brudney recognizes the public character of the hypothetical bargain when he observes that "it substitutes an interventionary process for a regime of private autonomy." Brudney, *supra* note 11, at 1408 n.15. The distinction between the private and social consensus is at the root of the debate over enabling and mandatory rules. *See* Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989).

[103]The default position often prevails because it is usually mutually tolerable and because of status quo friction (defaults are "sticky" in various respects). In the specific case of the fiduciary proscription, the onus is on the fiduciary to make a clear request to be released from the primary personal control on self-dealing. Consider Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998).

[104]Legal regulation establishes a formal cage of freedom (and bubble of security) for each person. Where it is default regulation, there are gates to larger or smaller cages. The main gate to a proposed alteration of the boundaries of one's cage is the consent of the parties or communities affected by any negative externalities.

The premise of the hypothetical bargain argument seems to be that only private governance is at issue. That premise is plainly deficient. Properly understood, corporate governance involves balancing the interests of three groups of actors: investors, managers and third parties who interact voluntarily or involuntarily with the firm. Many commentators wrongly limit the governance question to the interests of investors and managers. Corporate legislation is clearly suffused with trade-offs or accommodations between the *three* groups.[105] Accordingly, corporate statutes cannot be characterized as generic bargains that investors and managers would have made. Those two parties can clearly contract around default rules that affect them alone, but they cannot contract around rules that are mandatory (that implement nonnegotiable social objectives), or require the agreement of third parties (employees, creditors).

The standard form function, it may be noted, is often alternatively described as a gap-filling function. That appears to involve a conceptual, or perhaps interpretive, confusion. The standard form argument is that, for efficiency considerations, parties intentionally adopt the default position. To the extent they choose not to contract around the default position, they are bound by it. They rely on the default terms provided by the state to complete their agreement. There is, on that view, no gap to fill. If gaps do remain, there are no default rules left to fill them. All of the unaltered default rules were run into the contract the instant the parties finalized their agreement. Any remaining gaps can only be filled, if at all, by implying terms from the actual actions and circumstances of the parties, based on the usual tests (business efficacy, officious bystander). Accordingly, the gap-filling terminology is unsatisfactory. Presumably its use persists because congruency with the standard form idea is assumed.

Although not articulated at the time by Easterbrook and Fischel, an ostensible attraction of the standard form rationale is that it appears to fit neatly into the incomplete contracting approach, where default rules would be understood as just another means of addressing contractual incompleteness. At the same time, however, default rules are state constructions and, in that respect, fit uneasily with the nexus ideology that economic structures are simply manifestations of contractual autonomy. A reliance on the state to complete or perfect our contractual interactions lays bare our frequent dependence on state action. Easterbrook and Fischel, we will see, apparently were not troubled by the conceptual connection.

---

[105]The point has been made in the business trust context. *See* Flannigan, *supra* note 81, at 285-91.

Easterbrook and Fischel returned to the task of explaining fiduciary accountability in 1993.[106] Their thinking had evolved, apparently influenced by the nexus of contracts view of the firm.[107] They recast or reinterpreted their analysis in "contract" terms, leaving behind their 1982 recognition of fiduciary responsibility as a discrete obligation. They explicitly denied that fiduciary responsibility was a separate form of legal regulation. As they now understood it, there was nothing unique about fiduciary duties, they were just part of a continuum of *contract* rules.[108] Fiduciary obligation was "not a distinctive topic in law or economics."[109] Embedding themselves in the incomplete contracting approach, Easterbrook and Fischel stated that "the duty of loyalty is a response to the impossibility of writing contracts completely specifying the parties' obligations."[110] In their view, a fiduciary relation was "a contractual one characterized by unusually high costs of specification and monitoring."[111] Finally, maintaining their recourse to the hypothetical bargain, they claimed that "courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced."[112]

The argument that fiduciary accountability is entirely contractual, like the nexus idea it tracks, only operates at a very general level of abstraction. It denies any boundary between fiduciary and contractual obligation because it is not sufficiently sensitive to detect or differentiate that boundary. All fiduciary obligations are "contractual" or consensual in the narrow sense that fiduciaries agree in some manner to *assume* the obligation.[113] In most cases, fiduciaries agree to an other-regarding status (agent, director, parent) and

---

[106]Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993).

[107]See the contract model earlier described by Robert Hessen, *A New Concept of Corporations: A Contractual and Private Property Model*, 30 HASTINGS L.J. 1327 (1979).

[108]They insisted that fiduciary duties "are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings." Easterbrook & Fischel, *supra* note 106, at 427. Their explanation of the jurisprudence was that: "When transactions costs reach a particular high level, some persons start calling some contractual relations 'fiduciary,' but this should not mask the continuum." *Id.* at 438.

[109]*Id.* at 446.

[110]*Id.* at 426.

[111]*Id.* at 427.

[112]*Id.*

[113]This is to give Easterbrook and Fischel the benefit of the doubt. The fact of consent may appear to be suspect or remote in many acknowledged fiduciary contexts. An individual who consents to a sexual relation, for example, may unexpectedly assume the fiduciary obligation of a parent to a child. Consent is ostensibly less problematic in the corporate context (the source of the consent is an issue), but any premise for fiduciary accountability must have general validity. Consider Victor Brudney, *Revisiting the Import of Shareholder Consent For Fiduciary Loyalty Obligations*, 25 J. CORP. L. 209 (2000). The proper question is whether an arrangement is one of limited access, however created.

thereby assume the associated default proscription to not serve their own interest. That agreement or contract, however, is different from other contracts. The *content* of a contract matters. Some contracts are exhausted by the completion of the immediate exchange. Others establish and govern ongoing arrangements. Contracts attract fiduciary duties when they produce an arrangement of limited access. When actors assume other-regarding functions, they typically acquire access to the assets of their beneficiaries. The potential mischief is that they will divert the value of the assets to themselves or their associates. It is that prospect that has led judges to impose the fiduciary constraint on the self-regarding impulse.

Contracts that produce limited access arrangements are different *in kind* from contracts that produce only open access arrangements, where the parties may freely consume or exploit the assets they acquire through the contract. Judges in the early cases saw the difference very clearly. Easterbrook and Fischel do not see this difference in contractual content. They see only a difference in degree (of costs) between fiduciary duties and contractual duties. Fiduciary contracts in their view are simply those that have "unusually high costs of specification and monitoring."[114] They *define* fiduciary relations in that way. And if that was all there was to it, they would be right to deny any substantive distinction and to call for a "contractual" understanding of the obligation. But there is more to it. It is not enough to conclude, as they do in their final sentence, that: "Contract and fiduciary duty lie on a continuum best understood as using a single, although singularly complex, algorithm."[115] They need to appreciate what contracts do, not simply that "contracts" are present.

The general law of contract and the general law of fiduciary obligation have distinct social functions. Contract law serves as a channel to formalize permissible private agreements to assume legal (state enforceable) obligations. Fiduciary accountability is designed to control opportunism in limited access arrangements. It *supports* contractually established (and other) arrangements by regulating the opportunism associated with proximity to the assets of the undertaking.[116] There is no continuum relation between the two forms of obligation. Instead, they overlap, and, to the extent they do, they are parallel concurrent obligations. There is no connection at all where

---

[114]Easterbrook & Fischel, *supra* note 106, at 427. The one-sided example they offer of a trading restriction on a brokerage firm is curious. The broker/client relation is not one where costs of specification and monitoring are high. Additionally, the example involves a first instance adjudication, rather than one where the default rule is already in place and fully priced out. It also ignores the costs to investors if the trading restriction were eliminated. Easterbrook and Fischel clearly do *not* establish that both sides would be better off without the restriction.

[115]*Id.* at 446.

[116]Flannigan, *supra* note 1, at 40-41.

they do not overlap (open access contractual arrangements, non-contractual fiduciary obligations).

Easterbrook and Fischel insisted that the contractual character of fiduciary obligation is confirmed by the fact that both courts and legislatures tend to create default rules rather than mandatory ones.[117] According to them: "To say that express contracting is allowed is to say that the law is designed to promote the parties' own perception of their joint welfare."[118] However, it will be appreciated that the ability to contract around rules does not prove that the content of those rules represents the bargain the parties would have made. It is equally consistent with the conventional view that the content represents the social consensus on the default parameters for given arrangements.

Easterbrook and Fischel also confidently asserted that their contractual view implied that different fiduciary classes will have different fiduciary duties: "That fiduciary duties deviate substantially from one agency relation to another, no one could deny."[119] They are wrong on that.[120] It is quite clear, certainly in conceptual terms, that conventional fiduciary accountability has a constant application across all classes of fiduciaries. The mischief is generic and, consequently, the regulation is generic.[121] There is one general proscription on self-interest, with various manifestations of that one proscription represented in the various specific rules (e.g., against trading with principals, competing with them, taking opportunities). Not every specific rule will be engaged in each situation, but they are all potentially applicable. There are some idiosyncratic statutory exceptions, but generally fiduciary accountability has a generic operation. That generic operation may be obscured for Easterbrook and Fischel by the diversity they see in the performance or exculpation provisions of the contracts of different nominate classes of fiduciaries.

In the end, the Easterbrook and Fischel contract approach fails to deliver a useful analytical framework. It is conceptually limited at the level of abstraction they adopt. Apart from that, even on its own terms, it does not

---

[117]Easterbrook & Fischel, *supra* note 106, at 429.

[118]*Id.*

[119]*Id.* at 432.

[120]*See* Flannigan, *supra* note 1, at 42. In the corporate context, the potential for production opportunism on the part of directors does not vary as between public and private (or close) corporations except to the extent that management and investment in the latter are combined (i.e., the agency issue disappears). Where agency (or limited access) remains, conventional fiduciary regulation continues to have a constant application.

[121]Easterbrook and Fischel attempt to demonstrate the variation in fiduciary duties by listing some of the attributes of several classes of actors. Easterbrook & Fischel, *supra* note 106, at 432-34. No authorities are offered for the supposed attributes and many of those attributes are misleading or irrelevant.

suggest any substantive weakness with the conventional form of fiduciary regulation, other than to insist that it be regarded as "contractual." Nevertheless, despite its apparent analytical vacuity, the "contract" approach has influenced other commentators.

The 1993 contribution from Easterbrook and Fischel was a product of, and response to, the discussions that ran through the 1980s (e.g., investor wealth maximization, stakeholder interests, enabling versus mandatory rules, close corporation governance) about the suitability or relative efficacy of fiduciary and contract/market mechanisms to control managerial conduct.[122] A general fiduciary duty was said to be efficient.[123] Others argued that fiduciary rules were less efficient than contractual incentives and market supervision. The counterargument was that contractual incentives and markets were themselves costly and imperfect.[124] The hypothetical bargain

---

[122]*See, e.g.*, Bebchuk, *supra* note 102; Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989); Brudney, *supra* note 11; Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99 (1989); Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS, *supra* note 29, at 55, 55-79; John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989); John C. Coffee, Jr., *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919 (1988); John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986); John C. Coffee, Jr., *The Uncertain Case For Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435; Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U. L. REV. 1 (1985); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, DUKE L.J. 879 (1984); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989); Fischel & Bradley, *supra* note 17; Charles J. Goetz, *A Verdict on Corporate Liability Rules and the Derivative Suit: Not Proven*, 71 CORNELL L. REV. 344 (1986); Alan R. Palmiter, *Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence*, 67 TEX. L. REV. 1351 (1989); Phillips, *supra* note 17; Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927 (1983).

[123]Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 998, 999 (1981):

> Thus, the law makes it unnecessary for a principal who delegates power to manage his property to an agent to provide by contract an array of prohibitions against the agent diverting to himself the principal's assets. The law of fiduciary obligations does that. It thereby facilitates specialization in economic enterprise, which enhances productivity for society, by saving the cost of individually contracting for the agent's loyalty in a myriad of situations, not all of which can be anticipated.

[124]Market control is impersonal in that it lacks the "high-powered" incentive of personal civil liability. Markets are also ineffectual in various respects. For many arrangements there may be no market or only a thin one. Some markets will operate on poor information flows (the advisory function is typically formally constrained by confidential information rules). Even where there is a significant market, information will not register below a certain threshold. Information that remains concealed will not register at all. First-time spontaneous behaviors will be free to the extent their cost was not earlier factored into price. Market mechanisms (e.g., takeovers) can also be relatively

was heavily criticized.[125] Political considerations were explicitly raised.[126] Labels were fashioned: "contractarians" were opposed by "anti-contractarians" and "communitarians." The level and tenor of the debate may be gauged by articles published by Branson[127] and by Butler and Ribstein[128] at the end of the decade. Overall, the discussions were broadly based and often did not directly address conventional fiduciary accountability (as opposed to the general control of managerial discretion). Where it did surface, there was no real argument that the conventional obligation should be altered or eliminated. Easterbrook himself conceded that fiduciary rules were "important in inducing managers to take care of investors' interests."[129] His caveat was simply that they were "not the only safeguards, or even necessarily the most important ones."[130]

The conceptual struggles between "contract" advocates and their critics continued, with considerable methodological redundancy, through the following decade.[131] Toward the end of that period, a number of

---

expensive and are therefore not credible deterrents to significant levels of opportunism on the part of individual managers. Consider that exclusive reliance on markets would imply that all opportunistic conduct short of the threshold application of market discipline would be unobjectionable. That is an untenable distinction of mere degree or quantum. On market efficiency generally, see Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. CORP. L. 715 (2003). *See also* William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551 (2003).

[125]*See* Brudney, *supra* note 11, at 1414-16; Clark, *supra* note 122, at 68-71; Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1721-26 (1989); DeMott, *supra* note 122, at 885-92; Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1550-52 (1989); Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1451-57 (1989). *See also* Brudney, *supra* note 18, at 599 nn.11-12; David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991).

[126]*See* Lynne L. Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REFORM 19 (1988).

[127]Branson, *supra* note 18.

[128]Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

[129]Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 543 (1984).

[130]*Id.*

[131]*See, e.g.*, Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997) (book review); Mark Blair Barta, *Is the Imposition of Fiduciary Responsibilities Running from Managers, Directors, and Majority Shareholders to Minority Shareholders Economically Efficient?*, 38 CLEV. ST. L. REV. 559 (1990); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990); Douglas M. Branson, *The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law*, *in* PROGRESSIVE CORPORATE LAW 93,

commentaries illustrated that the debate over the distinction between contractual and fiduciary obligation remained unresolved. Brudney attempted to illuminate the distinction by contrasting traditional fiduciary analysis with traditional contract analysis.[132] Hadfield began with the "theory" of incomplete contracts and concluded that fiduciary accountability imposed "an obligation on each of the parties to act as if he or she faced the welfare function defined by the contract and/or the nature of the arrangement, rather than his or her own private welfare function."[133] Smith challenged the argument that the hypothetical bargain involved the maximization of investor value.[134] His view was that the fiduciary duty of managers was to maximize the value of the corporation, specifically, "the value of the sum of financial claims against the corporation."[135] FitzGibbon sought to establish that fiduciary relations were distinct in both "doctrinal structure" and "ethical basis."[136] The latter three contributions from Hadfield, Smith and FitzGibbon, among several others, are of additional interest because they are clear illustrations of commentators again assuming overly broad (and different) conceptions of the role of fiduciary accountability.[137] Their broader views led them into extended over-analysis that submerged the basic simplicity of the conventional function. That function is to control opportunism in limited access arrangements. Fiduciary

---

93-110 (Lawrence E. Mitchell ed., 1995); William W. Bratton, *Public Values and Corporate Fiduciary Law*, 44 RUTGERS L. REV. 675 (1992); William W. Bratton, *Self-Regulation, Normative Choice, and the Structure of Corporate Fiduciary Law*, 61 GEO. WASH. L. REV. 1084 (1993); Rutleford B. Campbell, Jr., *Corporate Fiduciary Principles For the Post-Contractarian Era*, 23 FLA. ST. U. L. REV. 561 (1996); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991); Paul N. Cox, *The Public, the Private and the Corporation*, 80 MARQ. L. REV. 391 (1997); Eisenberg, *supra* note 52; Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies From a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266 (1999); Park McGinty, *The Twilight of Fiduciary Duties: On the Need For Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 EMORY L.J. 163 (1997); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993); Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265 (1998); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998); Robert B. Thompson, *The Law's Limits on Contracts in a Corporation*, 15 J. CORP. L. 377 (1990); Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L. REV. 540 (1995).

[132]Brudney, *supra* note 18.

[133]Gillian K. Hadfield, *An Incomplete Contracting Perspective on Fiduciary Duty*, 28 CAN. BUS. L.J. 141, 142 (1997).

[134]Thomas A. Smith, *The Efficient Norm For Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214 (1999).

[135]*Id.* at 218.

[136]Scott FitzGibbon, *Fiduciary Relationships are Not Contracts*, 82 MARQ. L. REV. 303, 305 (1999).

[137]FitzGibbon, for example, assumes that the fiduciary duties of guardians include duties to educate wards and to maximize opportunities for their personal growth. *Id.* at 347.

accountability is not designed to maximize welfare in any sense other than that. It is not concerned, absent opportunism, with the merits of an exercise of any power or authority.

The turn of the century changed nothing. To the present day there has been little resolution in any of the various debates, or the underlying contest of ideology.[138] One development to note, however, is the articulation of a "team production" theory of corporate law. As described by Blair and Stout, the theory is that team members structure their relations to address the problems of shirking and rent-seeking that would otherwise affect team production.[139] The solution team members notionally choose is an internal governance structure Blair and Stout called a "mediating hierarchy." Team members cede control to an independent hierarch to mediate disputes over the allocation of production. The presence of the hierarch gives comfort to team members in making firm specific investments. The hierarch, in turn, is

---

[138]*See, e.g.*, Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767 (2000); Bainbridge, *supra* note 52; Lucian Arye Bebchuk & Assa F. Hamdani, *Optimal Defaults For Corporate Law Evolution*, 96 NW. U. L. REV. 489 (2002); William W. Bratton & Joseph A. McCahery, *Incomplete Contracts Theories of the Firm and Comparative Corporate Governance*, 2 THEORETICAL INQUIRIES L. 1 (2001); Eli Bukspan, *The Notion of Trust as a Comprehensive Theory of Contract and Corporate Law: A New Approach to the Conception that the Corporation is a Nexus of Contract*, 2 HASTINGS BUS. L.J. 229 (2006); K.A.D. Camara, *Shareholder Voting and the Bundling Problem in Corporate Law*, 2004 WIS. L. REV. 1425; Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 HOFSTRA L. REV. 175 (2004); Reza Dibadj, *Beyond Facile Assumptions and Radical Assertions: A Case For "Critical Legal Economics,"* 2003 UTAH L. REV. 1155; Reza Dibadj, *Delayering Corporate Law*, 34 HOFSTRA L. REV. 469 (2005); Reza Dibadj, *Weasel Numbers*, 27 CARDOZO L. REV. 1325 (2006); Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393 (2005); Kent Greenfield, *New Principles For Corporate Law*, 1 HASTINGS BUS. L.J. 87 (2005); G. Mitu Gulati et al., *Connected Contracts*, 47 UCLA L. REV. 887 (2000); Henry Hansmann & Reinier Kraakman, *The End of History For Corporate Law*, 89 GEO. L.J. 439 (2001); Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27 (2003); Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779 (2002); Thomas F. McInerney, *Implications of High Performance Production and Work Practices for the Theory of the Firm and Corporate Governance*, 2004 COLUM. BUS. L. REV. 135; Michael J. Meurer, *Law, Economics, and the Theory of the Firm*, 52 BUFF. L. REV. 727 (2004); David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491 (2004); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002); George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1103 (2004); Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861 (2003); Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333 (2002).

[139]Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *Team Production Theory*]. *See also* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403 (2001); Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999).

disciplined by fiduciary duties. Blair and Stout see the team members as making a decision to replace the costs of shirking and rent-seeking with the costs of hierarchy. They believe their theory improves on the principal/agent and property rights approaches, and is consistent with the nexus of contracts view. According to them: "Our break with previous work is to stress the importance of the coordination that happens not from the top down, but in the lateral interaction among team members."[140] They believe the theory provides a richer description of corporate law: "In particular, the law of public corporations appears to actually *eliminate* the role of the principal, imposing in its place an internal governance structure—the mediating hierarchy—designed to respond to problems of horizontal coordination inherent in certain forms of team production."[141] Interestingly, while Blair and Stout acknowledge the earlier team production analysis of Alchian and Demsetz, they criticize its assumption that employees make no special investment in the team. They thought that Alchian and Demsetz had, "by reducing the team members to interchangeable parts that make no firm-specific investment, reformulated the team production problem as a vertical principal-agent problem. In doing so, their model provided a rationale for why one party to the team emerges as the 'principal.'"[142]

There are a variety of general concerns with the Blair and Stout analysis.[143] On the specific matter of the duty of loyalty, however, there is little to address because little is offered. They began their short discussion of the duty with the surprising and unqualified statement that "American law has interpreted the duty quite narrowly."[144] They were of the view that the duty extends only to "self-dealing of the most obvious and egregious kind" and to taking corporate opportunities.[145] That is conceptually and descriptively too narrow. In conceptual terms, conventional fiduciary accountability applies to self-dealing in all respects, whether egregious or

---

[140]Blair & Stout, *Team Production Theory*, *supra* note 139, at 264.

[141]*Id.* at 265.

[142]*Id.* at 267.

[143]For general commentary on the Blair and Stout analysis, see John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837 (1999); Gregory Scott Crespi, *Redefining the Fiduciary Duties of Corporate Directors in Accordance With the Team Production Model of Corporate Governance*, 36 CREIGHTON L. REV. 623 (2003); Peter C. Kostant, *Team Production and the Progressive Corporate Law Agenda*, 35 U.C. DAVIS L. REV. 667 (2002); Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629 (2002); David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000).

[144]Blair & Stout, *Team Production Theory*, *supra* note 139, at 298.

[145]*Id.* at 298-99.

not.[146] As a descriptive matter, any quick review of the jurisprudence will reveal numerous judicial applications of "fiduciary" liability to matters other than self-dealing. While those applications are unjustified in conventional terms, they do negate the supposition that the duty of loyalty has consistently been interpreted narrowly. Blair and Stout go on to state incorrectly that the duty of loyalty does not extend to nonmonetary benefits that result from strategic business decisions. They assert that "directors do not breach their duty of loyalty when they use firm funds to build a lavish headquarters, or to make donations to their favorite charities."[147] In fact, those would be actionable breaches if the self-regard of the directors could be proved. The directors, it should be understood, are not liable merely because the decisions are formally conflicted. The authority conferred on the directors to make those decisions constitutes consent to the existence of the conflict. There is, however, no consent to the directors actually making those decisions for self-interested reasons. The difficulty, obviously, is in proving the self-interest. It appears that the directors receive no benefit except vicariously through the benefit received by the corporation.

Apart from those observations, Blair and Stout are essentially correct in their understanding of the conventional duty of loyalty (which they distinguish from the duty of care) as a mechanism to control self-dealing. They incorporate that view into their model, stating that "we observe that case law on the duty of loyalty appears consistent with the mediating hierarchy model we are espousing."[148] According to them: "This is because the duty of loyalty, as conventionally and narrowly defined, protects employees, creditors, and other stakeholders just as much as it protects shareholders. After all, when directors use their corporate position to steal money from the firm, every member of the coalition suffers."[149] Thus, for Blair and Stout, the fiduciary duty of directors is generally beneficial because it deters the diversion of the value of corporate assets. In the result, the team production model comprehends or incorporates conventional fiduciary duty as one means to control the production opportunism of the mediating hierarch.

A concluding observation is that the legal commentaries examined above were concerned almost exclusively with corporate law. Over the same time, a few commentators applied economic analysis to the law of trusts.[150]

---

[146] *See* Flannigan, *supra* note 102, at 909-11.

[147] Blair & Stout, *Team Production Theory*, *supra* note 139, at 299.

[148] *Id.*

[149] *Id.*

[150] Henry Hansmann & Ugo Matei, *The Functions of Trust Law: Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434 (1998); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625 (1995); A.I. Ogus, *The Trust as Governance Structure*, 36 U.

While potentially helpful, those contributions are largely derivative applications of the ideas found in the corporate material (and coincidentally suffer from the same analytical weaknesses), and the bulk of the discussion is concerned with general trust structure and doctrine. There is no original exploration of the economic basis of fiduciary accountability.

In the end, it plainly appears that conventional default fiduciary accountability (the duty of loyalty) is not opposed by economic principle. On the contrary, it appears to be the one accepted constant in the various corporate law debates. Whatever views commentators take of the scope of the fiduciary jurisdiction, they invariably include as their baseline the conventional regulation of self-dealing. However it is explained, whether as direct social engineering, or as a hypothetical bargain, fiduciary accountability functions as an appropriate legal mechanism to control opportunism. It shares that function with a collection of economic mechanisms. Fiduciary and economic accountability together support the commitments we make to serve the interests of others. Presumably, it is a different matter for wider conceptions of "fiduciary" responsibility. Controversy over the suitability of those other conceptions likely reflects concern with their economic utility. That, however, is for others to address.

V. CONCLUSION

There is no mystery to the economics of fiduciary accountability. Our *experience* with each other drives us to establish parameters for unilateral action. Part of our collective experience has been to endure the consequences of unauthorized opportunism. We view those consequences as pernicious. They corrode our interactions, our dependencies, our faith in others. We have made a *choice* to reduce the costs of opportunism by incurring the costs of default fiduciary regulation. We believe our choice maintains the integrity of our limited access arrangements. No economic argument has credibly challenged that choice. While there is no empirical data of any consequence, the universal assumption appears to be that the conventional duty of loyalty is an efficient mechanism to control opportunism in limited access arrangements. Whether it is more or less efficient than other mechanisms in all respects may not ultimately matter. It

---

TORONTO L.J. 186 (1986); Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004); Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565 (2003).

Fiduciary accountability in other contexts (partnerships, nonprofits, etc.) has been the subject of economic analysis. *See, e.g.*, John Morley, *For-Profit and Nonprofit Charter Schools: An Agency Costs Approach*, 115 YALE L.J. 1782 (2006); Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537 (1997); A.I. Vestral, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523 (1993).

is the one mechanism that allows us to personalize to individuals, through the assignment of strict civil liability, our deep concern with fiduciary duplicity.